SPECIAL CONVERSATION

Turning Social Challenges into a Driving Force for Growth: Two Leaders on the Resolve and Execution Required for Transformation

INFRONEER × HITACHI



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Hitachi has declared it is no longer a manufacturing company, announcing its pivot to the Social Innovation Business. Meanwhile, INFRONEER Holdings holds that it is not a construction company whose work ends once something is built; under the banner of "de-construction," it continues to transform itself into an integrated infrastructure service company that reaches beyond the bounds of the construction industry. While their paths differ, their aspiration is identical. What both companies have their sights on is management that turns the resolution of social challenges into a driving force for growth. How have these leaders translated such ambitious visions into reality? The two executives sat down to discuss what achieving this goal would take.

Facing Social Challenges as Public Institutions of Society: A Shared Philosophy of Transformation

Kibe The foundation of our current business model lies in the structural challenges facing Japan's infrastructure. As the population declines and ages, the roads, water supply, sewerage systems, and public facilities built during the high-growth era are all reaching their renewal phase at once.

Maintaining these systems through conventional methods, however, is not easy, even in fiscal terms. Faced with this reality, we chose a path of lowering infrastructure maintenance and management costs while actually enhancing service quality through new technologies and business models. Furthermore, by also engaging in business and investment, we want to create a *sanpo yoshi* relationship, one that yields benefits for local communities, government, and our own company alike. That is the picture we have been striving for.

Higashihara *Sanpo yoshi* (a well-known Japanese business philosophy that emphasizes benefits for the seller, the buyer, and society) is an excellent expression. While modern business often prioritizes short-term shareholder value, if you press the question of why a company exists at all, it ought to serve as a public institution of society. Every employee should be able to feel that they personally had a hand in designing that bridge, or that they made a difference in society that day. That feeling is precisely what becomes the driving force that propels the company forward. Of course, earning money is essential. Without it, we cannot make the next round of R&D investment or provide returns to our employees. However, to borrow from The Analects and the Abacus, the abacus cannot come first; the order has to be the Analects and then the abacus. We must earn by being committed to social contribution, not by prioritizing profit above all else. If we get that order wrong, the company will not grow like it should.

The Question a Massive Loss Forced on Us: Redefining Where the Company Makes Its Money

Higashihara For the fiscal year ended March 2009, Hitachi recorded a loss of ¥787.3 billion, the largest for a Japanese manufacturer at the time. We were driven to a point where another significant loss could have resulted in the company's collapse. Takashi Kawamura, one of my predecessors as President of Hitachi, took full authority and spearheaded the turnaround, and Hiroaki Nakanishi, who followed him, put forward the concept of the Social Innovation Business as our medium- to long-term vision.

When I assumed the presidency in 2014, my immediate priority was addressing the loss-making structure within the parent company itself, which had persisted for more than a decade. Although revenue was growing and operating profit was in the black, net income for the period turned negative once profits were allocated to the minority shareholders of our twenty-two listed subsidiaries. There had been a culture of complacency, where it was acceptable for the parent company to run a loss because it was the one doing the R&D.

To dismantle this mindset, I decided on two things. First, if we were going to take the Social Innovation Business forward, we had to transform Hitachi into a company that makes money. And second, on the premise that domestic infrastructure demand would shrink with a declining population, we had to become a company that could compete globally. That said, at the time, the definition and purpose of the Social Innovation Business were still somewhat vague.

So I defined it in my own words as a business that leverages digital technology to enhance social infrastructure and improve people's quality of life, and I worked to embed that across the company.

Hitachi grew on the idea that if you make something good, it will sell, from five-horsepower motors to trains and computers. However, since the emergence of Microsoft in 1975, business models around the world have been shifting from hardware to software and services. I believe our inability to break free from a manufacturing-centric mindset was at the heart of that massive loss. Moving forward, the competitive edge will no longer come from cutting costs to meet market prices; it will come from listening to customers' problems, delivering solutions digitally, and raising added value. As our winning strategy changed, our business portfolio had to change as well. We undertook a rigorous scrap-and-build process, selling all twenty-two listed subsidiaries and reinvesting the proceeds into our growth areas.

Kibe MAEDA CORP. also posted a loss of ¥45.8 billion in the fiscal year ended March 2008, and we were forced to go as far as offering early retirement to our employees. Having lived through the full extent of this as General Manager of the Corporate Planning Department, I made a vow: never again. That determination remains the foundation of how I manage the company today.

However, the mindset on the ground does not always align with management's way of thinking. Many of our employees join us wanting to build the finest building in Japan or a great dam; for them, working on a large-scale project is itself a powerful motivator. Even when profitability declined, there was a widespread sense that such financial concerns were solely for management to worry about. To change that structure, we introduced the concept of "de-construction." We shifted from being a simple contractor that builds and hands over projects to taking part in the business as a

whole, from planning and design through construction, operation, and maintenance and management, generating value ourselves throughout. We needed to evolve into a company that thinks not just about what to build, but about where profit is generated and how we deliver value to society. This is the shift in perspective we have been championing.

Deciding What to Discard and What to Bet On: The Pain of Transformation and Executive Resolve

Kibe Even if you enhance infrastructure value and redefine how you make money, transformation will not progress without a change in the mindset on the ground.

To achieve this, MAEDA CORP. implemented a strict principle: we would no longer accept any project that was projected to be unprofitable at the time of the order. However, if the decision is left to the divisions eager to secure the contracts, internal self-correction rarely kicks in. Until around 2017, the corporate planning department doggedly reviewed the profitability of every single project, passing on any that did not meet our required criteria. There was pushback at the time along the lines of what young staff members with no site experience could possibly understand, and honestly the internal headwinds were strong. We persevered, and as a result MAEDA CORPORATION's provision for losses on construction contracts has remained near zero for roughly a decade, and the company has changed into one that no longer carries unprofitable work. I believe this discipline in selecting projects is what underpins our current high profit margins.



Higashihara We had a similar structure at Hitachi too. Engineers naturally prioritize the pride of craftsmanship, such as having delivered an exceptional power plant or installed a good system, often at the expense of profitability. This led to several instances where we accepted lump-sum contracts for thermal power plants that included civil works, despite lacking in-house expertise in building or civil engineering. While the equipment side was profitable, the construction component, which represented 60% of the contract value, incurred such heavy losses that it dragged the entire project into the red. When work sits well outside your core business, the risks become impossible to read.

Consequently, by 2018, I directed the company to cease all orders involving civil works, allowing us to focus entirely on engineering and equipment. By clearly defining what to discard and where to bet, our earnings before interest, taxes, depreciation, and amortization (EBITDA) margin reached 12% to 13%, and our stock price has grown about tenfold from its ¥500 level in 2016.

Kibe A leader's responsibility is twofold: the decision about what to abandon and, at the same time, the boldness to bet on future growth. In this regard, I too believe large-scale investments and mergers and acquisitions (M&A) are the ultimate tests of executive conviction and governance quality.

Higashihara The situation in which I felt this most keenly was the acquisition of the US-based digital engineering firm GlobalLogic. We were acquiring a company with ¥95 billion in revenue for ¥1 trillion, representing an EBITDA multiple of 34. This sparked intense debate within our Board of Directors, where ten of the thirteen members were independent outside directors. I put it to the board this way: it may indeed be an expensive purchase today. But which carries the greater risk, I asked: the purchase price, or the possibility that in five years we find ourselves unable to do agile development, jeopardizing the very viability of the business? If executive officers are the accelerator, then the Board of Directors is the brake. I believe the essence of governance lies in maintaining the balance between these two forces.

Kibe We encountered a similar situation during our acquisition of Japan Wind Development. At the time of the deal, Japan Wind Development had already divested its completed power plants, leaving only development projects that had yet to produce revenue. With virtually no operating profit and an investment exceeding ¥200 billion, the deal was difficult to justify through conventional financial metrics. At the board I put it this way: none of us here, myself included, will see a direct return. However, this project holds the potential to generate EBITDA on the order of ¥50 billion in the future. Why not take it on as an investment in the growth base that will support INFRONEER ten and twenty years from now? The outside directors offered a wide array of perspectives, making a consensus difficult to reach. Ultimately, however, the proposal was approved unanimously. It meant judging not on short-term performance or cash flow, but with our eyes on the future of infrastructure five years out, ten years out, and beyond. It was, I believe, precisely because we had a board that endorsed INFRONEER's management philosophy and could share the same perspective that we were able to make such a monumental decision.

Starting Transformation from the Top Down and Rooting It in Culture from the Bottom Up

Kibe What determines whether a transformation actually gets carried out is, I think, how many employees truly take ownership of their work. As companies grow, organizational silos, both vertical and horizontal, become more prevalent, and it becomes easier for people to think that something is not their job. Even with leadership initiatives and training, what remains at the end is pride, a wall in people's minds. To dismantle this barrier, we need a higher purpose. Without a purpose that resonates with everyone at a fundamental level, people will not commit themselves fully. Once a shared purpose is established, we can face specific objections such as regulatory constraints, lack of precedent, or deviations from industry norms one by one, carefully, and clear them away. The same goes for risk. Press people on who will take responsibility and the organization shrinks back. Turn the discussion into a constructive one about eliminating that risk, however, and people start contributing their ingenuity. I believe that an organization's potential is defined more by its will to take things on than by its ability. When there is a genuine commitment

to succeed, most obstacles become surmountable.

Higashihara Hitachi has also experienced firsthand the difficulty of getting all employees pointed in a single direction. Today, 60% of our workforce come from outside Japan, with diverse cultures and values. We established One Hitachi as our common language.

Initiative, in treating the resolution of social challenges as their own responsibility; empathy, in engaging in discussions through an understanding of others rather than imposing one's own view; and commitment, in fulfilling promises while mobilizing those around them. We called upon every employee to embody these three behaviors.

However, mindset shifts do not happen overnight. During the first three to five years of a major reform, there is no choice but to pull from the top down. The key is to demonstrate results to employees. Without the conviction that this approach will yield success, people will not act. Once that conviction takes hold, we transition to the next phase: fostering a bottom-up movement where employees take proactive initiative. Build a workplace where people feel empowered to speak their minds, and give credit for a good attempt. A leader's role, I think, is to cultivate that kind of environment.

Kibe In the sense that Hitachi's Lumada has created a container that anyone can use to access data from every department, it seems to serve as a mechanism for dismantling silos.

Higashihara Precisely. Lumada is a platform that consolidates the solutions Hitachi has developed over the years, allowing them to be combined and offered according to each customer's specific needs. It works rather like a showroom. This initiative arose from a deep reflection on our own internal silos. In 2014 and 2015, the divisions were so segmented that information from the field failed to reach me as president, leading to two consecutive years of missing our performance targets. To rectify this, we reorganized our business structure in 2016 into small business units under the direct control of the president, making the actual state of each business visible. Our objective was to dismantle silos and build a corporate structure that handles everything end to end, from identifying a customer's problem through to development and operation.

In tandem with this reorganization, we launched Lumada as a cross-business common platform. Today, it has become the symbol of Hitachi's growth.

Japan's *Sanpo Yoshi* Ethos Makes It Possible: The Social Infrastructure Operating System (OS) We Both Aim For

Kibe In fact, I believe the common infrastructure data platform we are building through our concession business is also very much in the spirit of Lumada. Every day, we collect vast amounts of data from the infrastructure we operate, including airports, roads, water systems, and arenas. Rather than letting this data end in optimization for each asset alone, we aim to accumulate it on a shared platform so that it can be used across the operation of different kinds of infrastructure. For example, the idea is to leverage data and insights gained from operating one facility to improve the maintenance and management of another piece of infrastructure or to enhance the services its users receive. This is a type of data that only a company like ours, which handles both construction and operation, can accumulate, and we are currently building that foundation.

Higashihara I believe we are heading in the same direction. While Hitachi takes a digital approach to unifying railways and energy, INFRONEER approaches it through civil engineering, building construction, and concessions. Only our points of entry differ. By around 2040, I envision infrastructure connected across industry boundaries such as transportation, energy, and construction, forming a single foundation that delivers the service best suited to every individual, a Social Infrastructure OS, in effect. I view both Hitachi's Lumada and the infrastructure data platform being developed by INFRONEER as steps on the road there. The goal is Society 5.0, a human-centered society that leaves no one behind.

Kibe The key to delivering the integrated infrastructure service INFRONEER envisions lies in a participatory society where every resident can engage with infrastructure freely. For many overseas smart city projects, the overemphasis on corporate profit has often resulted in a failure to earn residents' support. In this regard, Japanese values prioritize the welfare of society as a whole. I am confident that when Japanese companies, guided by the *sanpo yoshi* mindset, take this on, they will succeed without fail. Fundamentally, infrastructure exists to enhance human well-being. This is why we will keep pushing forward with free thinking, unconstrained by the boundaries of the construction industry, in service of the greater cause of solving social challenges.

Higashihara A determination to think through the interests of society as a whole will become Japan's strength in the coming years. With expertise in civil engineering and building construction alongside a concession service business, your company has what it takes to lead the way. I have high expectations for your evolution into an integrated infrastructure service company.

