We will further promote management based on return on invested capital (ROIC) and allocate the cash created through synergies from large-scale acquisitions to enhance shareholder returns and growth investments.

Yoshihiko Kawamura
Senior Vice President and Executive Officer, CFO

Joined Hitachi in 2015 after serving as an executive officer at Mitsubishi Corporation. Leveraging the experience he gained at Harvard Business School and the World Bank, he has played a key role as CSO (Chief Strategy Officer) since 2018 and has driven structural reforms and the design of the 2021 Mid-term Management Plan. He was appointed CFO (Chief Financial Officer) in April 2020.

Q First, please give us your thoughts on your first year since being appointed CFO.

The COVID-19 pandemic, which broke out in 2020, is unprecedented in the history of modern management in that this infection, representing a unique external variable, has infiltrated the economic system creating a huge impact. The thing that I emphasized first amid this crisis was returning to the basics of financial management, that is, cash flow management. We strengthened cash flow management with overall coordination of elements such as working capital, R&D investments, capital investments, and fixed costs and, as a result, in the fiscal 2020, despite a decrease in revenues and profit, the cash flow margin from operating activities was 9.1%, the highest in Hitachi's history.
We have been applying ROIC management since the first year of the 2021 Mid-term Management Plan. In addition to using online meetings worldwide, we entrench this approach within Hitachi by conducting regular training to encourage a deeper understanding of ROIC and weighted average cost of capital (WACC). I feel that by increasing the awareness of all employees through these types of day-to-day activities, the ROIC tree is tied directly into concrete actions in the various workplaces. We disclose ROIC for each sector to outside parties as well, and within Hitachi, we can monitor each business in even greater detail. ROIC is included in all in-house budget and settlement-related materials so that we can conduct discussions based on this. Even amid the COVID-19 crisis, we are enhancing ROIC management on a deeper level; for example, we see businesses with a negative ROIC spread (the difference between ROIC and capital costs) as causing damage to enterprise value, so we reexamine our business strategies in those cases.
In addition to taking out loans with financial institutions, Hitachi issues corporate bonds and commercial paper. Our policy is to maintain a debt/equity (D/E) ratio of less than 0.5x, considering a combination of factors that includes discussions with rating agencies. In fiscal 2020, however, the D/E ratio reached 0.54x at the end of March 2021 because we used loans to procure part of the capital to acquire ABB's power grids business. We plan to quickly get that ratio back down below 0.5x, eliminating debt by allocating profits from the sell-off of assets, as well as operating cash flow, which will increase through business growth.

Q Please tell us about your approach to M&A.

I have held a concurrent position as the head of the Investment Strategy Division since April of this year, and I'm able to look at investments and loans, so the financing and allocation of capital for acquisitions has been going even more smoothly than in the past. For example, we needed about one trillion yen for the acquisition of GlobalLogic, and we were able to move quickly in investigating capital financing procurement methods and simulations of the short- and medium-term impact of the acquisition on financial and management performance KPIs.
In general, when you announce that you are going to undertake an M&A project, there is a tendency for share price volatility to increase in the short term. If you want to control that volatility, it's important to clearly communicate a medium- and long-term equity story to the capital markets. In post-merger integration (PMI), the integration into consolidated management systems is completed in a comparatively short period of just a few months, but PMI takes two or three years after that to impact performance. We focus our efforts on garnering synergies in the medium to long term, as we amortize the intangible assets involved in the acquisition.
In terms of the impact of integration at Hitachi ABB Power Grids, we expect to see cost-reduction effects on a scale of about 100 billion yen by 2025, through the use of shared service functions involving the new company's indirect operations in Europe, including general affairs, HR, finance, accounting, and procurement. We are also promoting cross-selling and synergies with Lumada in each business sector and, in some cases, the impact has already become apparent.

Q Please tell us your thoughts on capital allocation.

In capital allocation, we have no immediate plans for large-scale loans or capital increases, but we will continue to increase operating cash flow through growth investments and secure funding by constantly switching out assets. We consider returns to shareholders to be an important theme. Our intent is to allocate about one-third of capital to each of three areas: returns to shareholders and repayment of loans, growth investments, and capital investments. We will also further enhance R&D investments, targeting cumulative investments of about 1.5 trillion yen over the three years from fiscal 2022.
Growth investments are growth drivers that increase enterprise value. There are two ways of achieving our goals for growth investments: "organic growth," where we increase the added value of Hitachi's own killer technologies, as in the case of particle beam therapy systems, and "inorganic growth," which is achieved by incorporating businesses from outside, like when we acquired ABB's power grids business. Capital growth strategies comprise regional strategies and sector strategies with a three-dimensional approach, considering the timeline for investment efficiency.
In regional strategies, we monitor the status of marginal income (increased profits in line with additional invested resources) for both the domestic and overseas business, and we are shifting the focus toward businesses with higher marginal income (overseas business in many cases). Moving forward, it will become increasingly important to factor in our global strategies and design optimum strategies specific to each region. There are two important elements to the sector strategies: the perspective of market positioning for Hitachi's products and services (positioning strategy), and resource-based strategies, which leverage Hitachi's technical superiority and other resources. In addition, we will back-cast from an ideal form of the future and study capital allocation taking into account R&D investments, M&A targets, and the economic and management viability of those initiatives.

Q What are your basic policies for returns to shareholders?

We will aim for returns to shareholders on three levels: not only dividends and share buybacks but also increasing stock prices (capital gains). We will monitor dividend yield levels in other businesses as well and aim for a stable increase in dividends based on business growth. We will consider and undertake share buybacks while conducting a variety of simulations, keeping in mind business growth, the sell-off of assets, and stock price levels. We will continue our efforts to increase shareholder value through intensive engagement with the capital markets.

Q In closing, please give us your thoughts on non-financial KPI information and disclosure of that information.

There are four important non-financial KPIs: governance, climate change measures, the value of human resources, and the happiness of human society.
Governance can be very difficult to present in the form of a KPI, but in addition to the diverse background and experience of the people who make up the Board of Directors, my goal is to be able to explain to outside parties how these directors engage in exchanges of constructive criticism with the executive side, as well as discussions related to ethical behavior at board meetings.
In climate change measures, Hitachi has set a target KPI of achieving carbon neutrality in our own operations by 2030, and we are accelerating these activities. We need to look at this problem from a broader perspective, however, so I believe we must show an aggressive stance and involvement in activities targeting this problem, while introducing how Hitachi will reduce CO_2 emissions in an economic society and how we can contribute to the global environment, presenting actual examples of R&D activities and specific contributions through business.
In terms of the value of human resources, first, it is important to explain clearly how we encourage diversity and inclusion within Hitachi. I can say with confidence that by fostering and training our people worldwide through day-to-day corporate activities in which we cultivate our technical strengths, we support the international competitiveness of Japan as a whole. I would like to set this as a kind of KPI, as a means of communicating Hitachi's contributions.
Finally, and I think that this is the most important perspective, there is the question of whether our corporate activities help to improve the public welfare; in other words, whether people's lives are more culturally oriented, healthier, and richer because of our corporate activities. This is the starting point for all corporate activities, so I want to keep this in mind as a corporate citizen and ensure that we continue to ask these questions of ourselves.
My approach to non-financial KPIs is to maintain a focus on these four perspectives and use these as key indexes for management as we undertake activities that tie into increased corporate value.