

A Message from the CEO

Five Years as CEO in Retrospect

Five years have passed since I became CEO. Looking back, I give myself 50 out of 100. I became the CEO with a vision for ORIX. I wanted to upgrade governance and change the back and middle office system. I had a lot of ideas, but not enough of them have become realities.

The presidents of many Japanese companies seem to slightly misunderstand governance. Essentially, monitoring the president is the most important aspect of governance. However, many presidents seem to consider governance as something for the Board of Directors as a whole rather than themselves. That misses the point. For example, some people back down immediately if

review process, but I do not want appointments to reflect my inclinations.

I can say that ORIX has produced some successful business outcomes. However, it has made some missteps in its investments outside Japan, largely because of a belief that human nature is fundamentally good. I think a majority of ORIX employees share that belief. It may work in Japan, but it is a recipe for failure when investing overseas. Instead, we have to put good faith aside and assume the worst. Failure came from assuming the best. An internal rate of return (IRR) at 10% or more makes even the worst case turn out well.

We provide employees with opportunities to fail.

They use that experience to build the future.

This corporate culture enhances ORIX's risk management and leads to future opportunities for growth.


We will transform change into opportunities to support steady growth.

I disagree slightly with what they are explaining to me. That is no good. People need to stand up for their arguments and defend them through discussion and debate. Such people are essential for good governance.

Another opinion is that outside directors should have that function. Generally, the president is largely involved in selection of outside directors in Japan and the United States, so outside directors are subject to criticism for being too friendly with the president who appointed them. ORIX has adopted the company with nominating committee system, and the Nominating Committee is responsible for appointing outside directors. I may interview candidates after the Nominating Committee's

One of the challenges over the last five years has been restructuring the back office. We established the Enterprise Risk Management Headquarters, hired internal lawyers to enhance back office legal affairs, and strengthened the Corporate Planning Department to reinforce management accounting. We have strengthened internal communication and ORIX Corporation USA is now enhancing the interface with accounting auditors and rating agencies using personnel in New York. They are only about half done, and that includes changing the mindset.

We are making rapid progress in localizing our overseas businesses. ORIX operates in 37 countries and has approximately 8,000 employees overseas, but only about



Makoto Inoue

Member of the Board of Directors
Representative Executive Officer
President and Chief Executive Officer

50 of them are Japanese expatriates. Over the past five years, the Overseas Business segment has grown to generate segment profits exceeding ¥100 billion annually.

ORIX Group's Business Model

Some may say that ORIX is difficult to understand because it has no comparable peers. We started off in leasing and expanded into neighboring businesses, but we did not have a strategically defined vision for growth. I might compare it to a Japanese inn that began by digging a hot spring and constructing the main building, then built an annex, then moved in a new direction to grow its business by creating an open-air spa and an amusement center. ORIX is an organization that expanded in this way.



I expect it will continue to support ORIX's growth in terms of business performance and organization.

The best way to make this large organization easy to understand was to make ORIX a holding company and organize all Group companies into business units. The idea of a holding company is that its individual companies, such as an automobile company that specializes in automobiles or an environment and energy company that specializes in environment and energy, are listed independently, while ORIX as the holding company is not listed. However, this approach takes significant time and effort. Even in our current configuration, the market will nullify the conglomerate discount associated with companies like ORIX or Japan's general trading companies if the market attaches greater value to individual Group companies.

Currently, ORIX has six segments that encompass 16 business units. These businesses are broadly categorized in three areas: Finance, Investment and Operation. Performance in the Finance category is challenging with interest rates as low as they are. However, Finance has a sales network throughout Japan, giving it a considerable information network and the ability to provide non-financial services. This network is exceptionally valuable, so I want to maintain it. I would also like to be ready for Finance to generate profits when interest rates rise in the future.

In the Investment category, equity investment is a matter of timing. However, we will lose money on equity investments if we only make them when the time is right and then do nothing with them. Portfolio replacement over a five- to ten-year investment horizon basically resembles an investment fund. Sometimes, however, what began as an equity investment becomes a core ORIX business. That case involves holding the investment longer and expanding the business or doing a roll-up to nurture it as a new core business for ORIX.

DAIKYO, which we made a wholly owned subsidiary in January 2019, is a recent example. It has about 50 technical personnel in areas including building construction and management. However, even though DAIKYO and ORIX Real Estate are subsidiaries of the same ORIX, the organizations were different as companies so DAIKYO's people seldom worked with ORIX Real Estate. I didn't like that situation, but until recently ORIX held a stake of about 65% in DAIKYO and couldn't call all the shots. We therefore made DAIKYO a wholly owned subsidiary and are currently integrating it with ORIX Real Estate. Some DAIKYO employees were disappointed that DAIKYO is no longer a listed company, but I have been encouraging them to help create a new post-integration company that can actually be listed.



ESG at ORIX

Corporate social responsibility and ESG management are current buzzwords. ESG stands for environment, society and governance, of which governance is most advanced at ORIX.

Regarding the environment, renewable energy is one of our businesses. We have approximately 1GW of solar power generation capacity in Japan, making ORIX one of the nation's largest solar power generation companies. In the future, I would like to externally report easily understood data about the environmental contribution we are making, such as how our business is reducing CO₂ emissions.

As for society, one of its most important aspects is human resources. We believe that employees are both assets and important stakeholders for ORIX, but our personnel policy still has room for improvement. Overseas personnel may be comparatively easy to deal with. Overseas, we will talk with employees to set KPIs, evaluate performance, and give bonuses of 200% and 300% depending on the degree of achievement of targets. On the other hand, they may have to leave the company depending on that same metric. That is a more unambiguous approach to human resource management that is

typical in the United States, but not in Europe or Asia. And personnel policies in Japan may well pose the greatest challenge among Asian countries.

A feature of Japanese human resource management that creates difficulties is not so much the lifetime employment system, but that the concept of using KPIs to evaluate performance has not taken hold. The KPIs overseas investees have shown us have been thick books. Detailed KPIs are necessary for determining bonuses in line with the degree of achievement. I've tried to introduce KPIs, but so far the approach hasn't worked out as I expected. As a result, personnel evaluation ultimately remains qualitative. Qualitative evaluation is acceptable, but young employees who receive a poor qualitative evaluation need to have a way to exit gracefully, an escape route from that work. Developing people through personnel changes is also important. Managers shouldn't treat the people who report to them as if they worked for them, without consideration of their subordinates' career plans. I regularly tell people at ORIX that they should consider letting even key people in their business units move on to a different unit as the next step in their career.

My View of Life and Work

I value fairness in my life and work. However, fairness often turns out to be a matter of personal preference. I have to keep in mind that I should never decide what is fair based on my own preferences. I also live by the Japanese saying, “A bird should not foul the nest it is leaving.” People shouldn’t burden their successors when they move on. Nor do others want to listen to complaints from my successors about how I did things. Many of our projects are long-term, and another person may take over part way through. I was in charge of a problematic project soon after I joined ORIX. It had been the project of a person who worked next to me and had joined ORIX before I had. I felt the approval memo that person circulated was not accurate. The person who had written the memo was next to me, but I felt I shouldn’t voice my concerns because he was my senior. I realized I never want to make problems for anyone who takes over a project from me.

In short, stay away from sloppy contracts and bad deals. Make sure not to cut corners, so everyone else can proceed with assurance. These were the first things I learned after joining ORIX, and I still value them.

Naturally, I have had my failures during my long career. Yet I believe that I just about always recovered properly after those failures. I was able to recover because I set limits for credit and investments, because I made judgments about what we could recover given the worst case scenario for the investment or investee. Bottom line, always keep the worst case in mind.

I knew my first customer in China for two years before we started doing business. During the two years, we had been holding discussions once every three months, and eventually he let me know it was time to decide whether

to provide funding or not. Still, I didn’t close the deal until I was convinced.

On the other hand, good deals disappear from the market almost immediately, but bad deals float around for months. In Japan’s bottom-up decision-making process, it takes about a month to vet a project internally. Naturally, good projects will not be waiting around at the end of that process. That’s why we must have enough market knowledge and information to make quick decisions. However, doing all the deals that have been given the go-ahead would also be a mistake. We need to do deals when we have sufficient information to make calm, cool judgments. We need to ask ourselves if the project we are considering is in fact just junk. That is how we avoid failure.

Also, we should stop if we think we need to stop, even if the president is eager to go ahead. Only three or four out of ten deals get through at ORIX. In many cases, when the president is eager to close a deal, price becomes a secondary issue. The reason why many Japanese M&A deals fail is because the price was wrong. In addition, most deals among shareholders are not good. Back in the day, I closed a strict loan deal with a hotel business in the United States, and had the following conversation with the borrower:

Borrower: Mr. Inoue, are you expecting trouble? The contract says that if there is a problem you get to keep all the collateral. That seems unreasonable.

Inoue: I don’t want collateral. I want you to pay off the loan.

Borrower: The contract says we will default if we are three days late. Work with me on that. Can’t you give us one week?

Inoue: OK. I’ll make that three business days, not just three days.

Learn, Then Experience

When I look at young employees today, because they can obtain information via the Internet so easily, they don’t make the effort to investigate properly for themselves.

Basic study is insufficient. In my time, I went to a bookstore to find out about foreign exchange by buying a book about letters of credit, or went to a library to look



for materials. If I still didn't understand, I found somebody who did, like making an appointment with a bank's foreign exchange officer, or going to a law firm to ask an attorney. Few employees do that these days. We should be aware that the shortcomings of information on the Internet are not so much problems with its quality as the fact that people do not assimilate it because it has not been acquired through experience.

And we have to face issues that really scare us. If I negotiated a deal that went wrong because of a mistake I made, I regretted putting the offending clause into the contract. This experience is important. Get scared, then study further. ORIX gives this kind of experience. One of my biggest concerns now is that ten years have passed since the financial crisis of 2009, and many people haven't

experienced a serious downturn. A person who was 30 years old 10 years ago is now 40 years old. If someone in this generation that has not experienced a serious downturn becomes a section manager, I am not sure he can lead his subordinates well. I am very worried about this. We need to provide employees with opportunities to fail and to acquire the ability to learn from experience. The time will come when the market crashes again and problems will multiply. By gaining experience in this business cycle, employees can acquire life lessons. Getting really scared is not a bad thing at ORIX. You can make use of that experience and redeem your mistakes. We believe this makes ORIX's risk management stronger, and makes us better able to capture opportunities for growth.

In Closing

The world is changing day by day, and various risks and opportunities appear and disappear before us with great speed. ORIX has grown into a top-class Japanese company in terms of earnings, but I am convinced it can still grow. We will not rest on the laurels of past successes,

but instead will steadily link changes in the world to the growth for ORIX by fully leveraging our experience with failure. I strongly believe this earns the trust of stakeholders and addresses their expectations.