



Insights from the CFO Survey

Industrial Manufacturing
Sector

15 April 2022

Industrial Manufacturing Sector
KPMG in Japan



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Executive Summary

What are the roles of CFOs in the industrial manufacturing (IM) sector in the SX era?

Putting weak administrative departments behind us

As we approach an era of full-scale SX (sustainability transformation), CFOs, in addition to their traditional roles, will be expected to take on greater responsibilities for enhancing corporate value. However, in addition to corporate division having a weaker position than business units in Japanese companies, many of their functions are dispersed. Corporate planning, and accounting and finance, are also separate departments in Japanese companies, and CFOs often do not oversee the corporate planning department.

In contrast, companies in North America and Europe have their CFO oversee many functions, including corporate development, accounting, treasury, tax, IR, risk management, internal audit, and systems, which establishes a strong control function over their business units.

With investor scrutiny intensifying and the importance of accountability of executives to the board on the rise, can decentralized corporate division manage the rapid decision making required to address such major changes as ESG and carbon neutrality? In order to make management decisions with a bird's-eye view, the SX era will require the CFO to have greater authority and control, and to exercise leadership as the key person for enhancing corporate value.

Executive Summary

Reasons why CFOs in the IM sector need to have greater authority and control in the SX era.

Reason

1

The need for business transformation to address SX — An objective evaluation by the CFO from a strong position

As the core of all industries, the IM sector will be required to review its business portfolio in the SX era.

This review should be carried out impartially and cannot be managed by individual business units; it requires a high degree of authority that is not influenced by the interests of business units, and the CFO's company-wide viewpoint is essential.

Reason

2

Addressing new risks arising from SX — Systematization of company-wide risk management by the CFO

The IM sector has a highly complex business structure, as it deals with a wide variety of businesses and products, and its value chains are often developed on a global basis. We can therefore infer that addressing new SX risks will be challenging. Companies will need to address such risks, including human rights, carbon tax and other tax risks. To do this, it is essential to build a robust governance system in which information on company-wide risks is reported to the CFO. Risk control also needs to be driven while prioritizing risks according to their level and impact on management.

Reason

3

Meeting non-financial disclosure requirements — Control by the CFO of all data that impacts corporate value

Due to its complex supply chains, disclosures of SX-related non-financial information are expected to be burdensome for the IM sector. It is imperative that such disclosures are promoted as a company-wide initiative, with the headquarters in Japan taking a lead and involving its overseas subsidiaries. There are expectations for CFOs to provide systematic explanations to stakeholders based on the global integration of an information gathering infrastructure through which the collection of financial and non-financial information is concentrated on the CFO.



01 Business Strategy The need for business transformation to address SX



Two characteristics of business strategy in the IM sector came to light: One is that **SX is a top priority (★1)** and the second is that **the review of the business portfolios is in progress (★2)**.



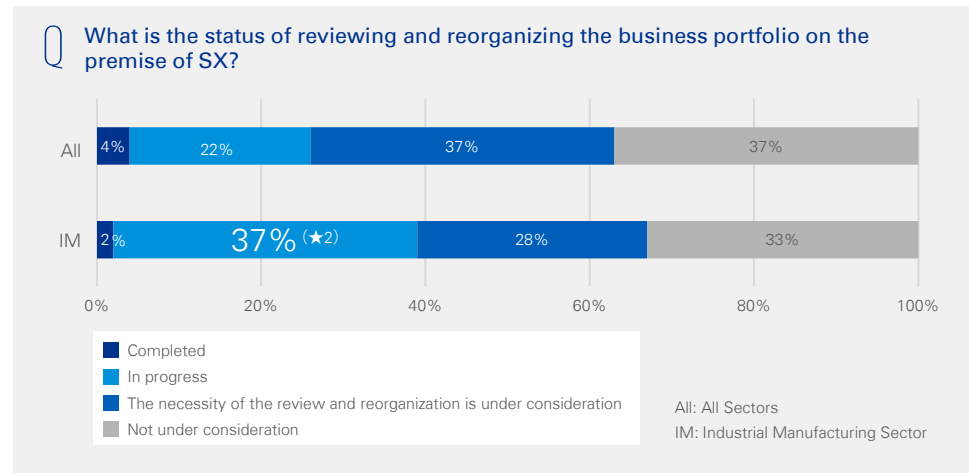
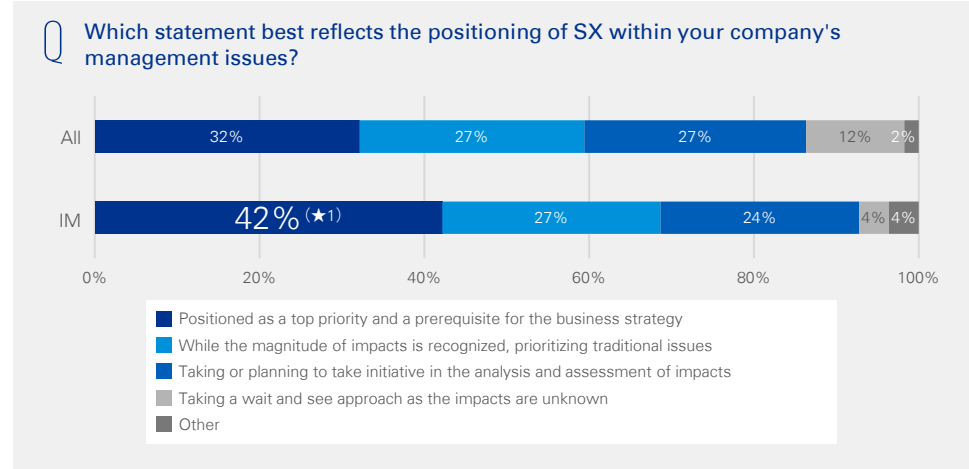
The first characteristic is explained by the following factors. The steel and metal industry, an upstream industry in the IM sector, consumes a large amount of energy, and therefore it has the highest barriers for achieving carbon neutrality. There need to be technological breakthroughs for converting fossil fuels to energy utilized in processing and manufacturing. The midstream industries of heavy electric machinery, industrial machinery, semiconductors, and electronic components, manufacture capital goods and key components needed by all industries. It is therefore important to develop facilities and equipment compatible with new energy sources such as ammonia and hydrogen, and devices that will accelerate energy conservation. And the downstream factory automation and lifestyle-related materials industries are expected to become SX enablers for the entire industry, by providing digital solutions that utilize such high-efficiency equipment and devices.



In other words, SX will be defined by the formation of an ecosystem in which the entire value chain is optimization-oriented, by connecting the entire IM industry from upstream to downstream and integrating the industry value chain. The business strategy for companies is therefore to consider their corporate role in achieving optimization of the entire industry.



And a review of business portfolios, the second characteristic, would be a company's first course of action in the business strategy for taking on their roles in an ecosystem that leverages such new technologies. The fact that the IM industry is taking this initiative ahead of other industries is indicative of its awareness that manufacturing is core for all industries.





02

Investment Strategy

The need for business transformation to address SX



Two characteristics of investment strategy and corporate funding in the IM sector came to light: an **increase investments in environmental measures (★1)** and **strengthening of R&D (★2)**.



Increase investments in environmental measures and strengthening R&D are factors common to SX, green procurement, and carbon tax developments, which are also issues for business strategy. Environmental investment has a risk hedge aspect, such as CO₂ reduction and waste reduction, while strengthening R&D has an aspect of improving added value, such as technology development and solution deployment.

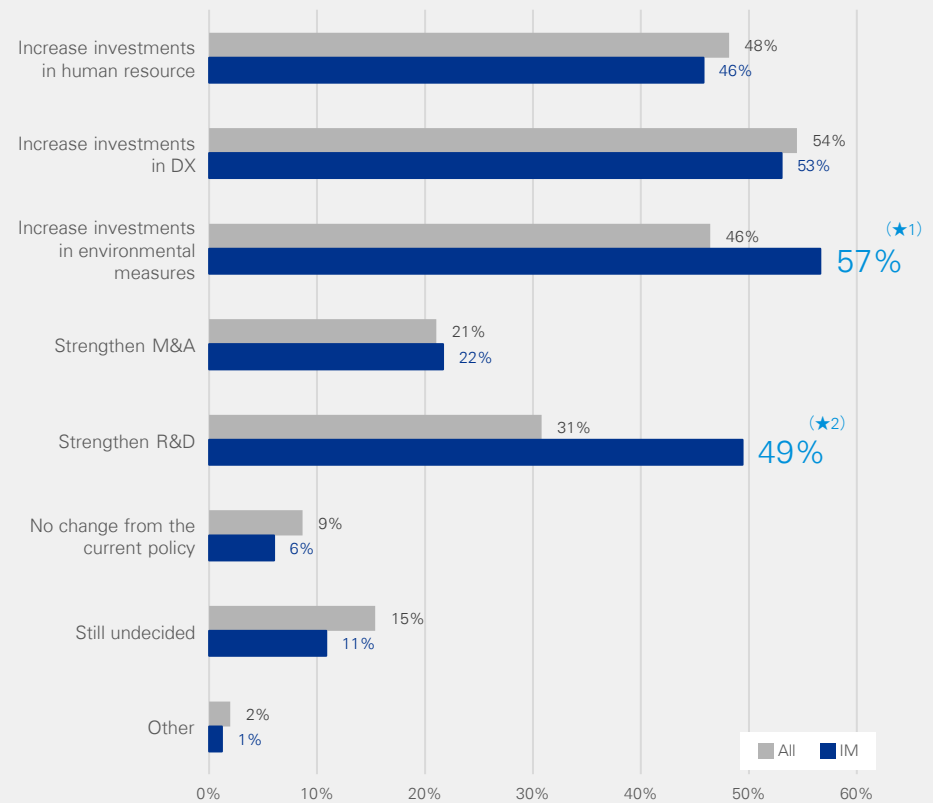


However, promoting both a defensive approach of environmental investments and an offensive approach of strengthening R&D will be an effective investment strategy in the IM sector. For example, a further acceleration of miniaturization and lamination of semiconductors will increase the yield per wafer and lead to downsizing, thereby improving chip performance and energy efficiency. This will be an investment that achieves both the defensive aim of energy conservation and the offensive aim of performance improvement.



Investment in Digital Twin development can also be effective in asset-heavy industries such as steel and metal, and heavy electric machinery. The traditional approach of building physical facilities and running the DBT (Design-Build-Test) cycle is a resource-consuming approach. The Digital Twin will allow the DBT cycle to be run digitally, significantly reducing resource consumption (defensive approach). The digital execution of the DBT cycle will also lead to a dramatic reduction in lead times, which in turn leads directly to inventory reduction and customer satisfaction (offensive approach).

Q How will you change your investment strategy in promoting SX?
Please select up to three answers.





03

Risk Management

Addressing new risks arising from SX



Because the IM sector conducts its business on a global scale, it is prone to significant risk of human rights violations. However, the survey results revealed that **very few companies (10%) cited human rights violations as a major risk (★1)**.



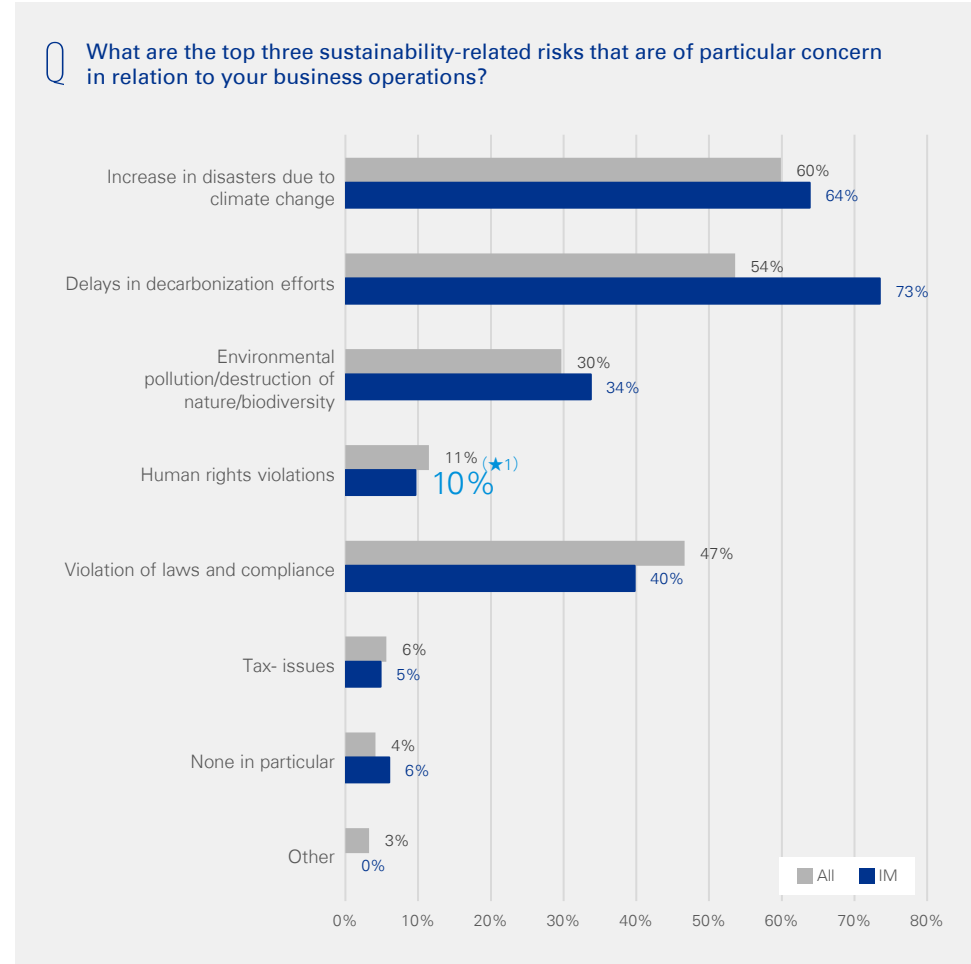
Human rights issues, however, are a much-discussed topic in relation to corporate activities and relevant legislation is being put in place, mainly in Europe. For example, the Supply Chain Due Diligence Act is scheduled to come into effect in Germany in 2023. Under this act, legal obligations regarding human rights will be applied not only to German companies but also to their business partners, which may affect Japanese companies.



There have also been developments in some U.S. and European companies in the establishment of procurement guidelines that take human rights into consideration, and this is beginning to influence their choice of suppliers. As this trend gains momentum, companies that do not address human rights issues may suffer by being forced out of the supply chain, putting pressure on their operations.



For companies to address such new risks, the corporate division units of their headquarters need to exert their leadership in promoting human rights due diligence and other measures on a global basis. Likewise, the CFO will be required to have an active involvement in terms of managing company-wide risks.





04 Tax Addressing new risks arising from SX



When asked about tax-related measures or considerations, approximately 40% of companies in the IM sector responded that they would provide tax incentives for investment (★1), reflecting the importance of tax incentives (tax credits) in their business and financial strategy.



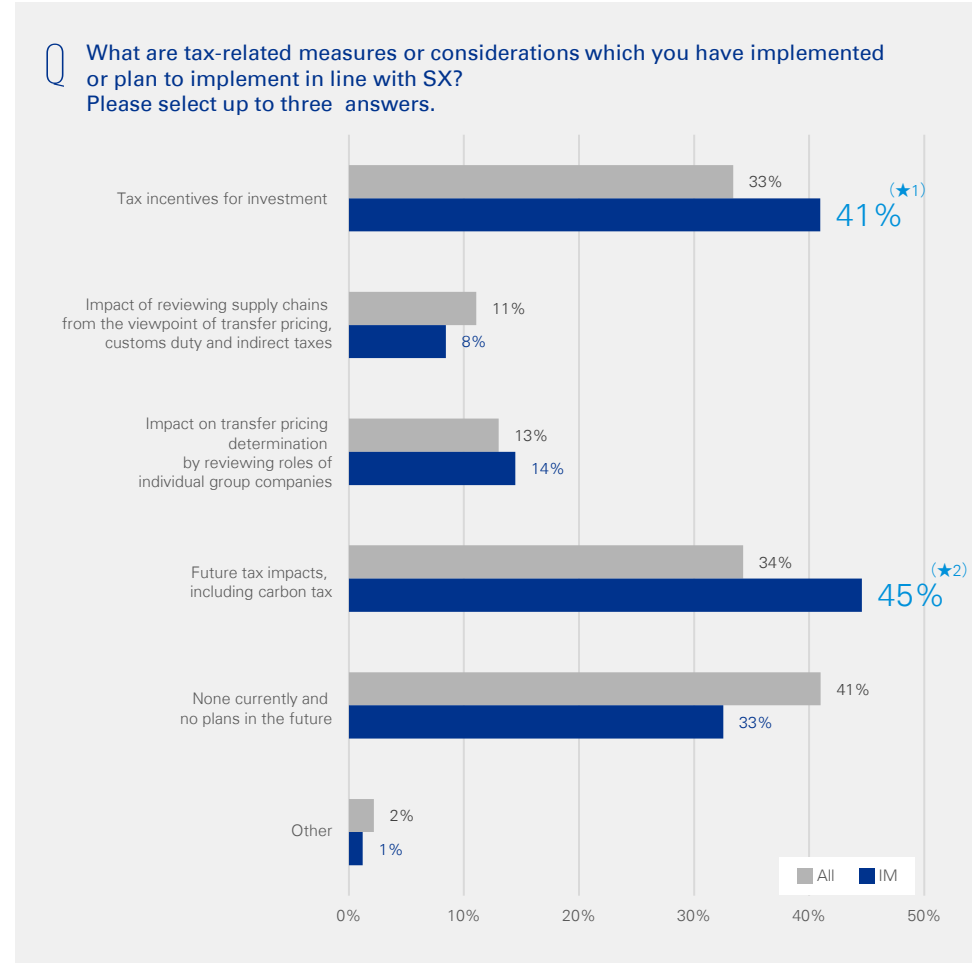
In addition, more than 40% of companies cited future tax impacts including carbon tax as a top priority management issue (★2), revealing that many companies view carbon tax as a new tax risk associated with SX.



Many operations in the manufacturing process lead to greenhouse gas emissions. A carbon tax, if introduced in the future, will inevitably have a significant impact on corporate management. Companies in the IM sector in particular will be required to prepare for this kind of tax, by analyzing tax policy trends and the possible impact on their businesses, and reviewing their business portfolios and management plans.



Companies need to establish a company-wide tax governance system so that such new tax risks are addressed under the leadership of the CFO, rather than individual business units. Overall, companies in the IM sector are ahead in establishing tax policies and monitoring the tax information of their subsidiaries. The results showed that this is particularly true for companies in subsectors such as electronic components and semiconductors, with more than half already establishing tax policies and monitoring systems. We can infer that many companies in the semiconductor business are ahead in their establishment of a tax governance system because they understand the importance of tax governance for staying competitive in other countries, and because their businesses and budgets are large in scope.





05

Comprehensive Reporting Including Non-financial Information

Meeting non-financial disclosure requirements



Many companies in the IM sector cited **additional administrative workload required (★1)** and **establishing a process and system for collecting necessary non-financial information (★2)** as issues related to corporate reporting of non-financial information.



In November 2021, the IFRS Foundation established the International Sustainability Standards Board (ISSB), which has been considering rules for the disclosure of non-financial information. In response to this, a common global standard will be developed by June 2022. This will largely determine the extent to which companies in the IM sector will be required to disclose such information.



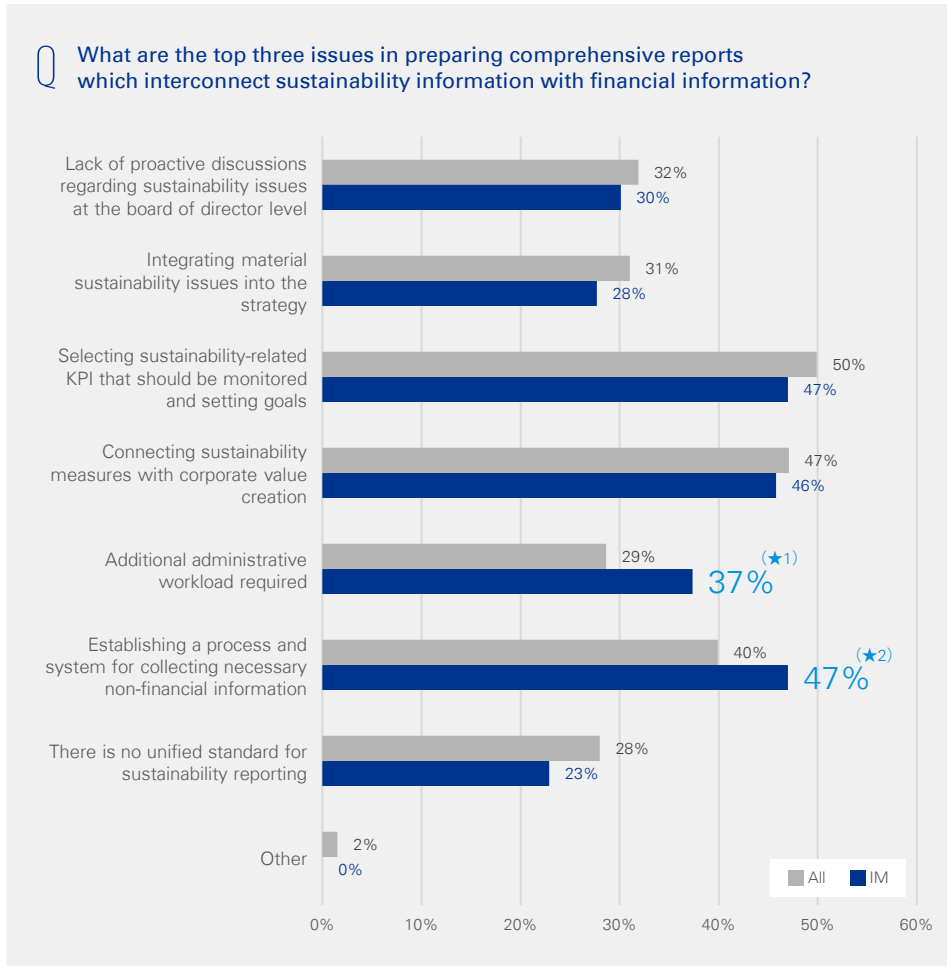
For example, the ISSB draft standard requires disclosure not only of Scope 1 emissions (direct greenhouse gas emissions from a company, such as emissions from its own factories) and Scope 2 emissions (indirect greenhouse gas emissions from the use of electricity, heat, and steam supplied by other companies), but also Scope 3 emissions (greenhouse gas emissions from entire supply chains of a company, such as procurement of parts). Because companies in the IM sector have complex supply chains, if Scope 3 is in fact included, they would be required to disclose significantly more items of emissions, leading to a considerable administrative burden for information collection and disclosure.



The framework for financial reporting by the accounting and finance department under CFO supervision is highly compatible with the framework for collecting non-financial information, and this know-how should be utilized. Non-financial reporting is an activity that should involve the accounting and finance department also from the viewpoint of preventing inconsistencies between financial and non-financial information.



CFOs need to exert leadership and establish a system and framework for disclosing effective non-financial information to investors in anticipation of future trends in standards and rules.

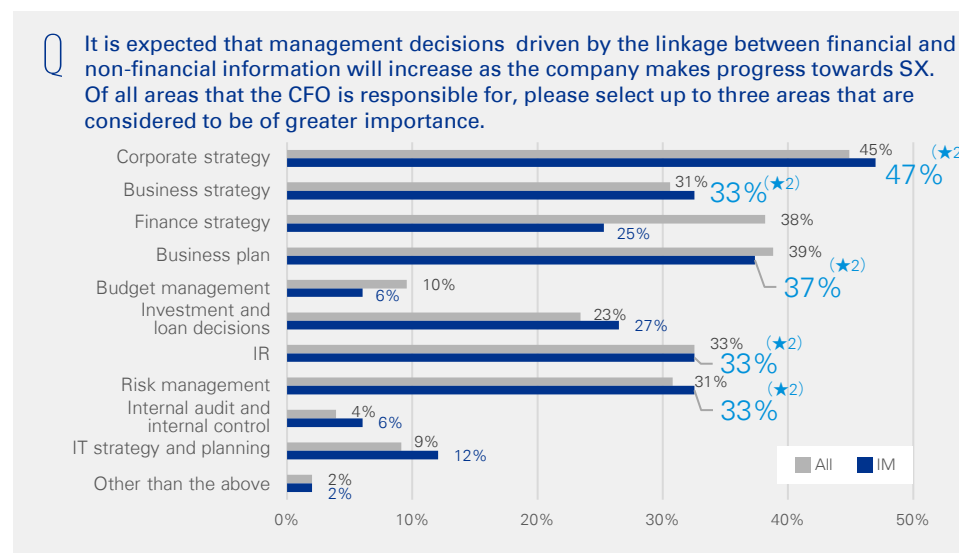
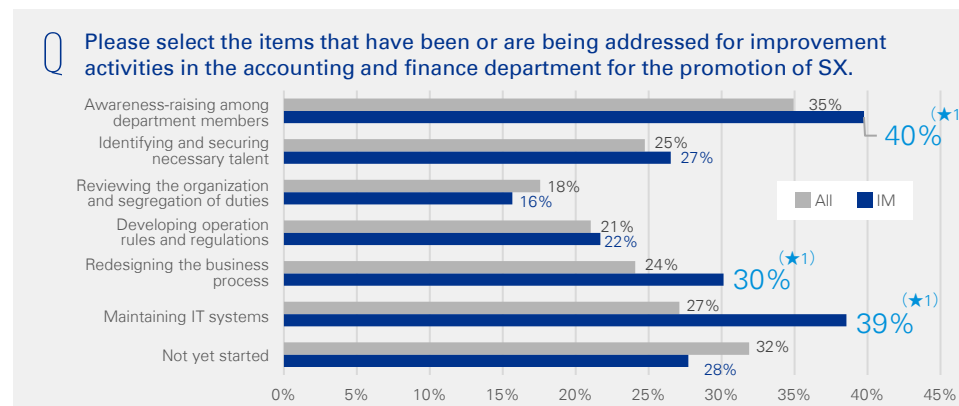


Reference: Accounting and Finance

In the IM sector, 47% of companies reported that they have already started improvement activities in their accounting and finance departments, compared to 34% of total respondents. A higher percentage of companies in the IM sector also cited [awareness-raising among department members](#), [maintaining IT systems](#), and [redesigning the business process \(★1\)](#) as items that have been addressed or are being addressed, compared to overall percentages. This may be indicative of the higher sensitivity among companies in the IM sector than in other sectors toward addressing an approaching full-scale SX, and their consequent emphasis on implementing improvements to their accounting and finance departments at an early stage.

Many companies in the IM sector cited [corporate strategy](#), [business plan](#), [business strategy](#), [IR](#), and [risk management \(★2\)](#) as areas for which CFO responsibility will increase in the future.

While some of these areas may not be considered traditional CFO roles in Japanese companies, we believe there is a growing awareness that CFOs will need to cover more areas as we approach the SX era.

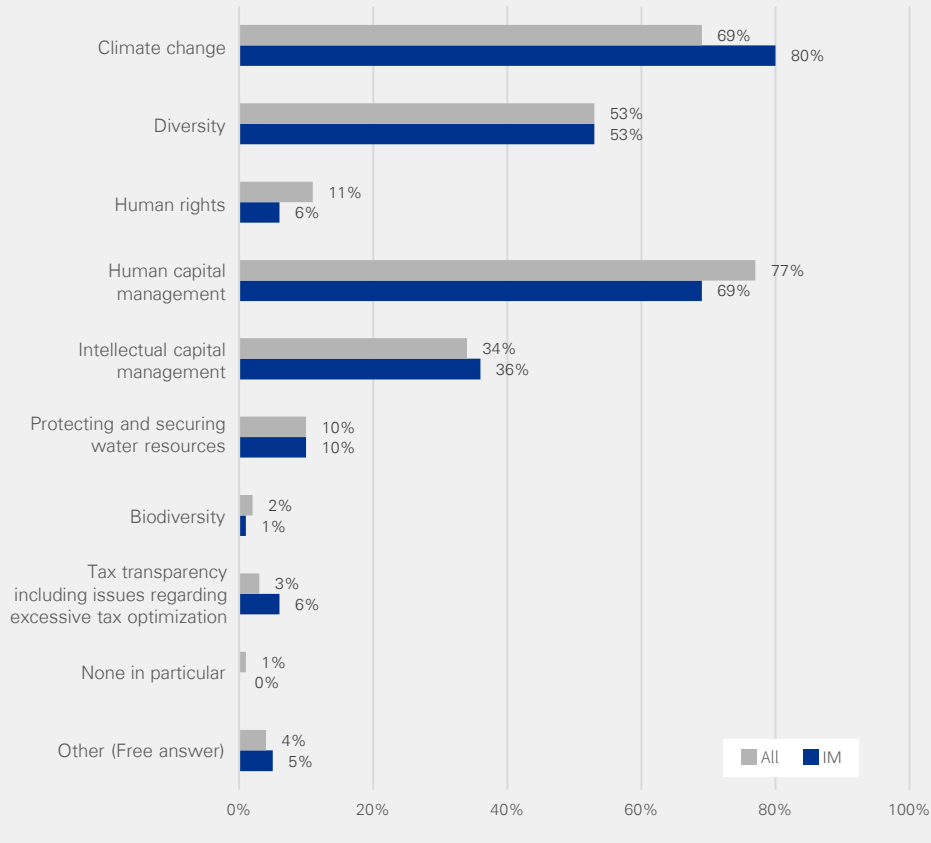




Survey responses

1.Introduction

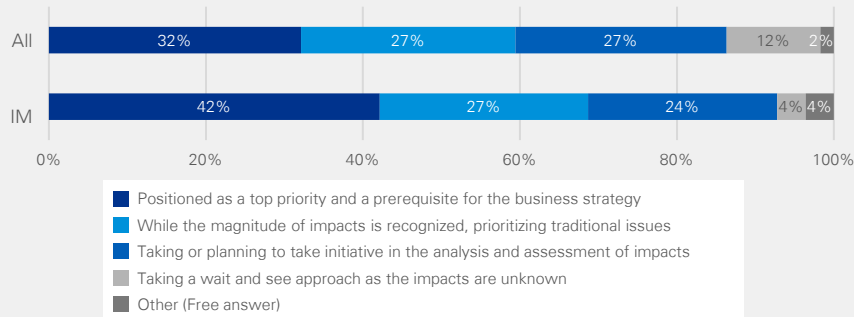
Q What are the top three sustainability-related issues that you think will greatly impact your corporate value at present or in the future?



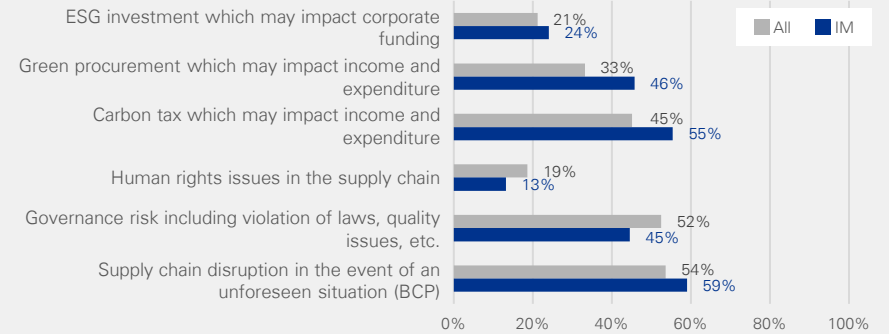
All: All Sectors
IM: Industrial Manufacturing Sector

2. Business strategy

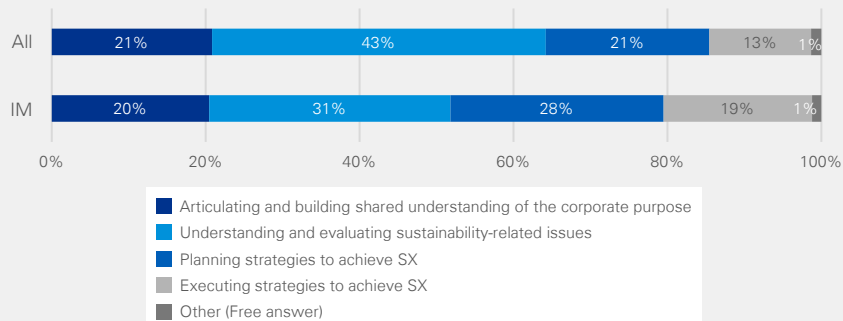
Which statement best reflects the positioning of SX within your company's management issues?



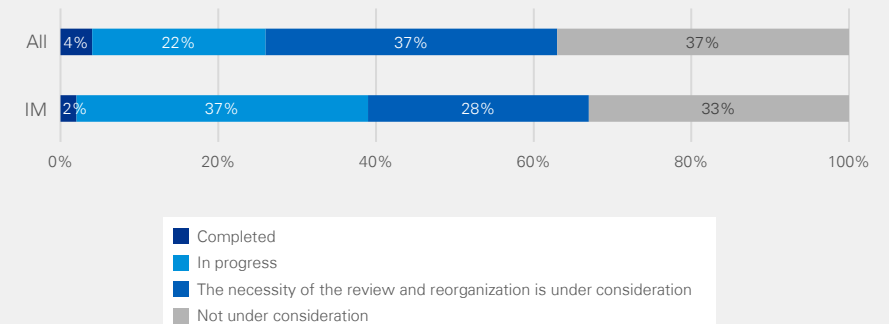
What are the top three concerns which you think will have a major impact on your company's current business strategy?



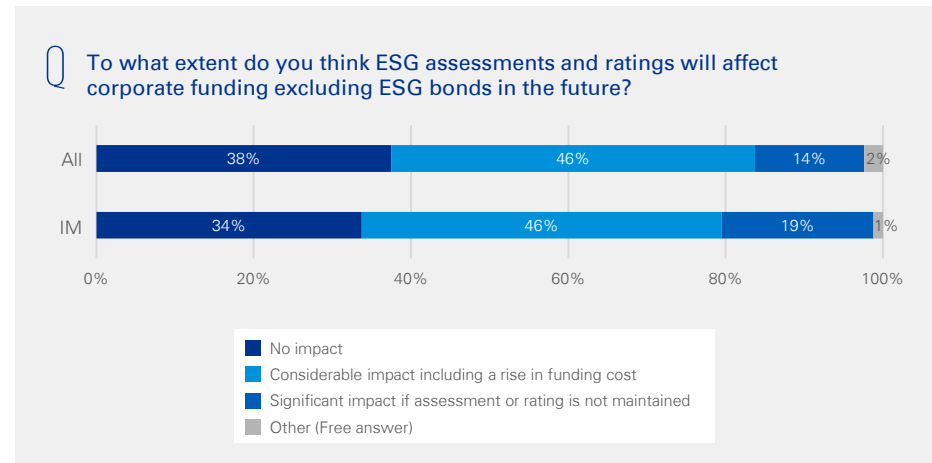
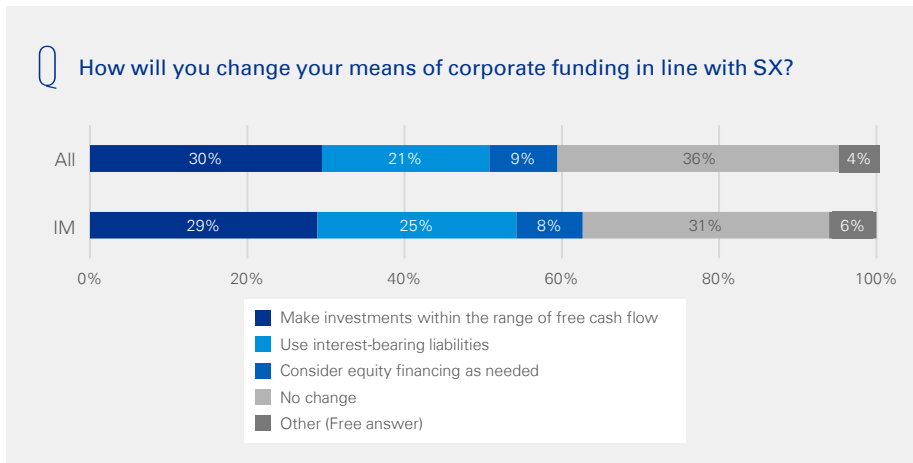
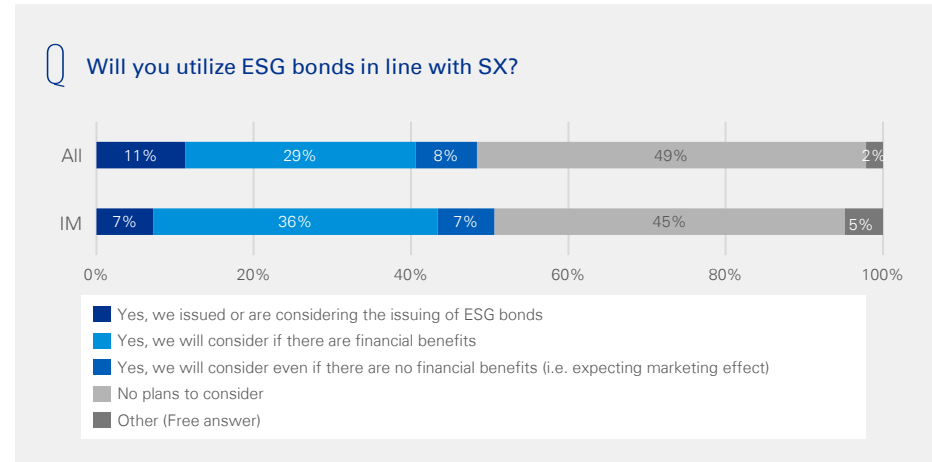
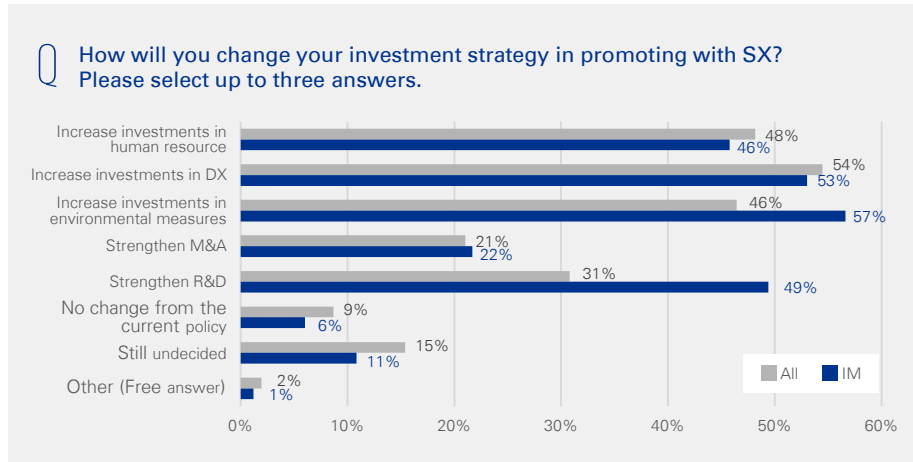
What is the most critical issue your company faces in promoting SX?



What is the status of reviewing and reorganizing the business portfolio on the premise of SX?

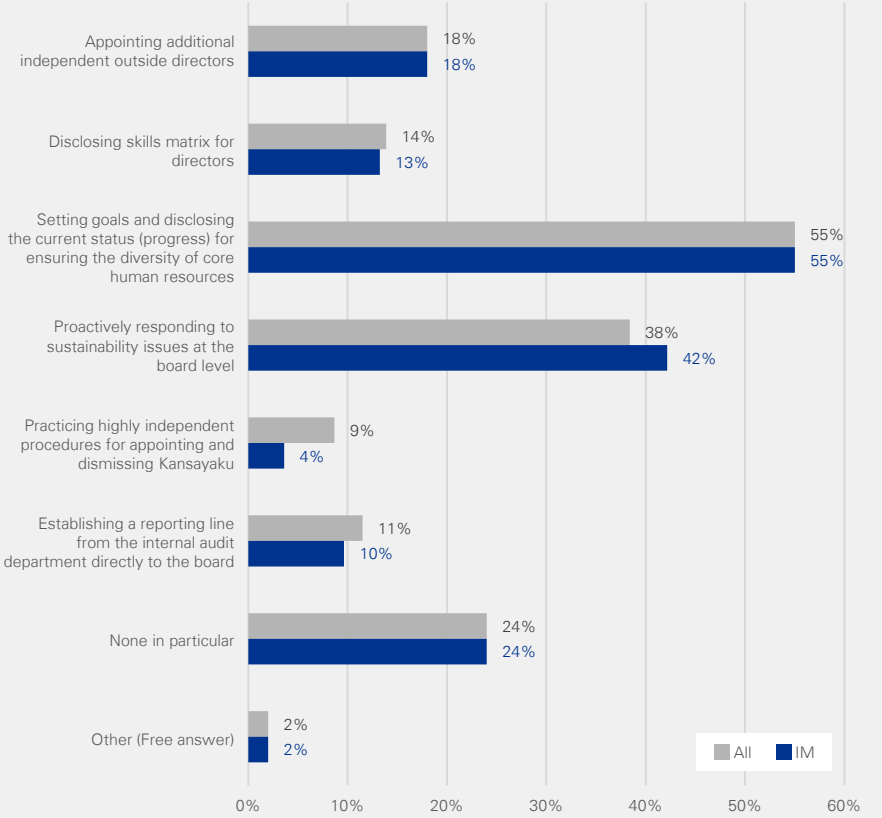


3.Capital policy and corporate funding

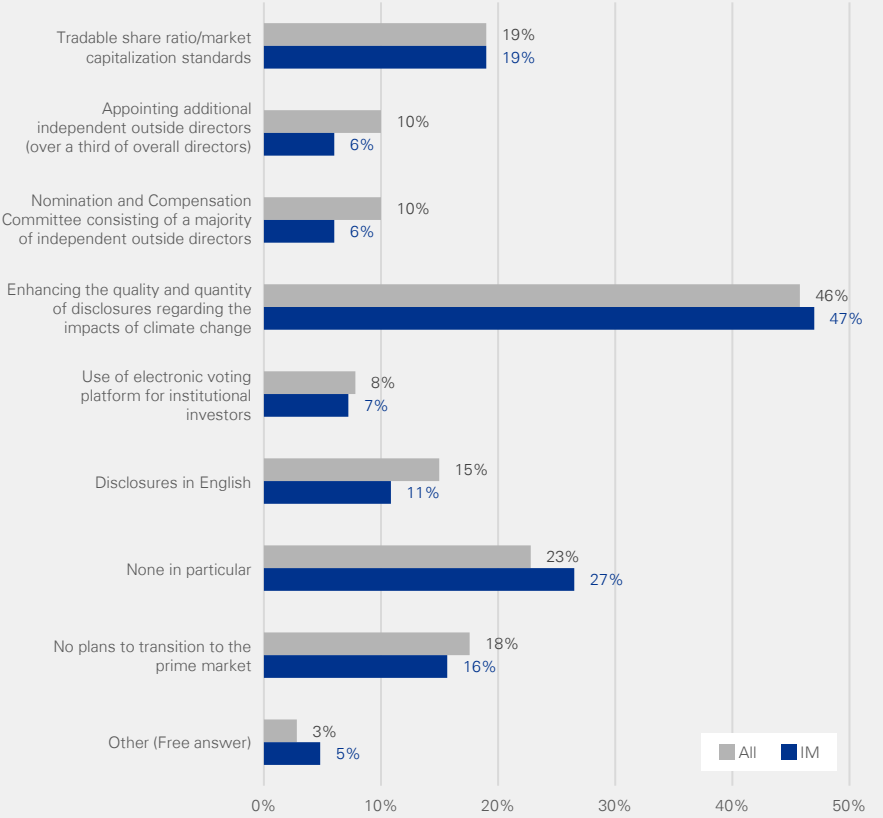


4. Governance

The revised Corporate Governance Code published in June 2021 incorporated some SX related matters in its principles. What are the top three items additionally incorporated in this revision which you feel are challenging to address?

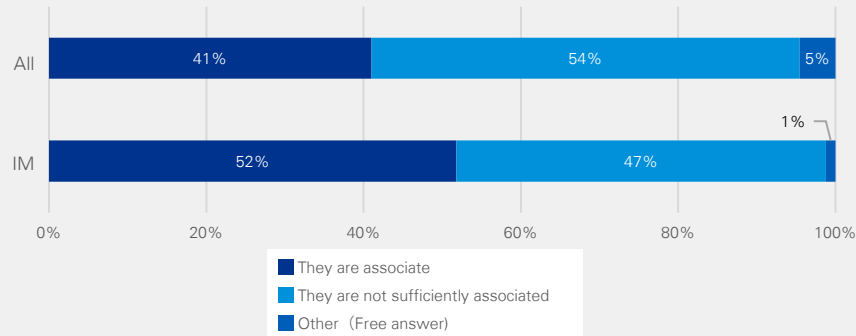


What are the top three criteria which you expect to be challenging when transitioning to the prime market?

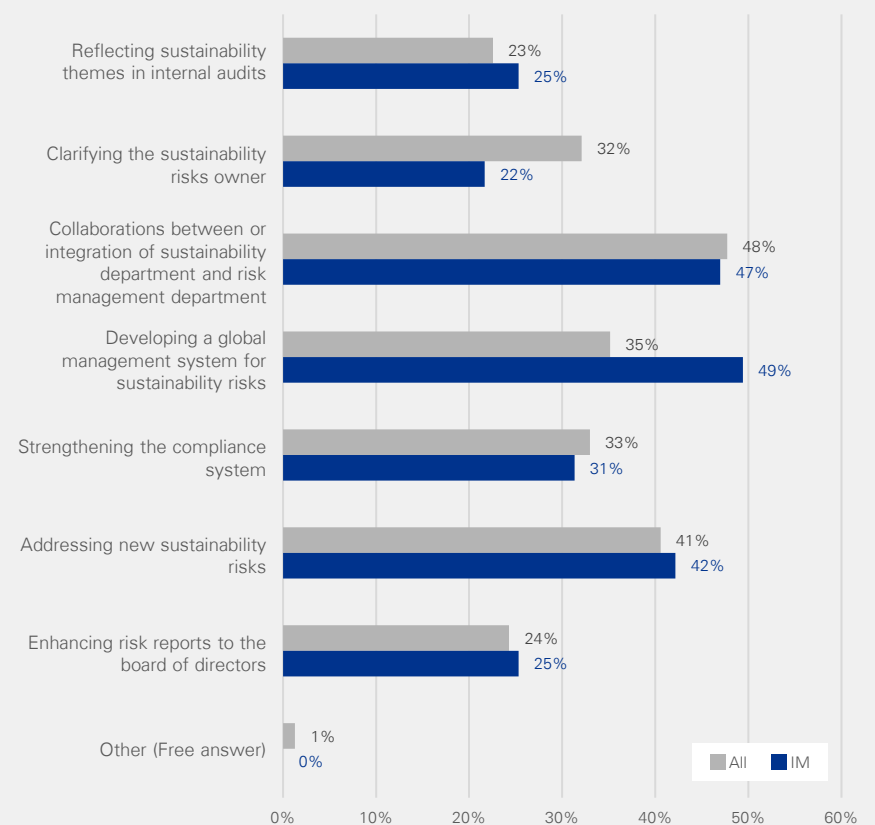


5. Risk management

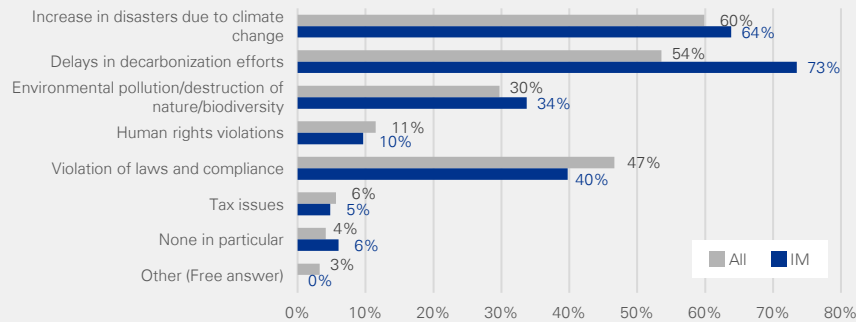
Q Are the risk management activities of your company designed and executed in association with material sustainability issues?



Q What are the top three initiatives in relation to the risk management system which you think are particularly necessary in proceeding with SX?

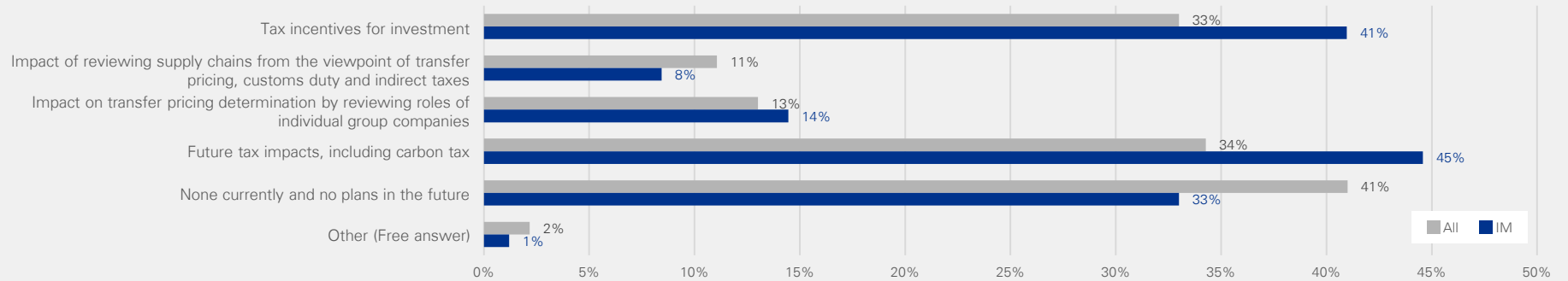


Q What are the top three sustainability-related risks that are of particular concern in relation to your business operations?

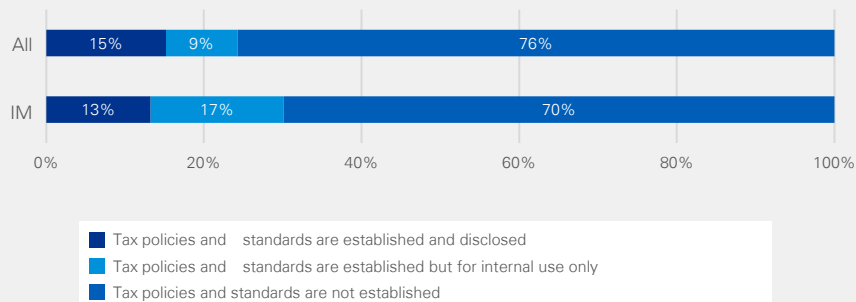


6.Tax

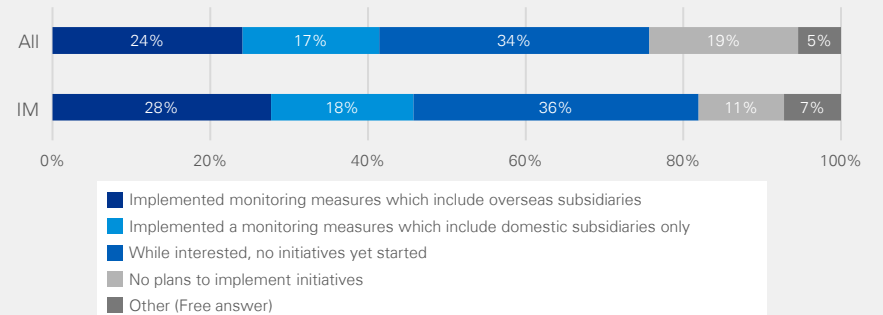
Q What are tax-related measures or considerations which you have implemented or plan to implement in line with SX? Please select up to three answers.



Q Does your company have tax policies and standards applying to risk tolerance and tax judgments that are disclosed?

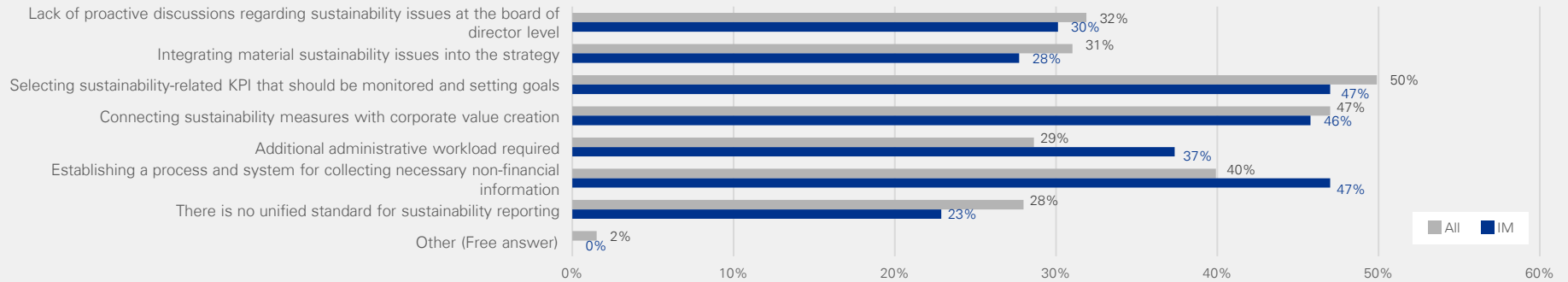


Q Which statement best describes the status of initiatives for visualizing your group companies' tax information?

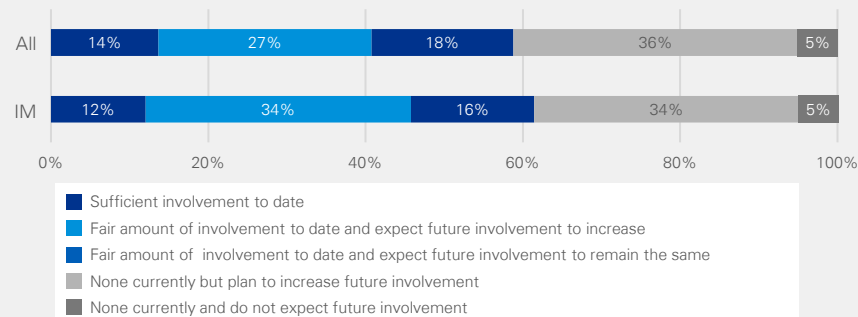


7. Comprehensive corporate report including non-financial information

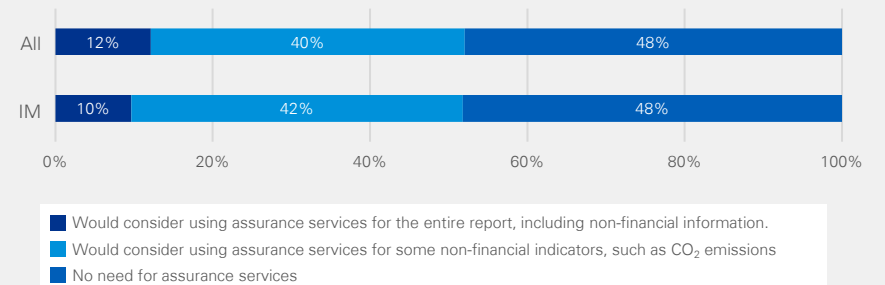
Q What are the top three issues in preparing comprehensive reports which interconnect sustainability information with financial information?



Q What is the current level of involvement of CFO in sustainability reporting?

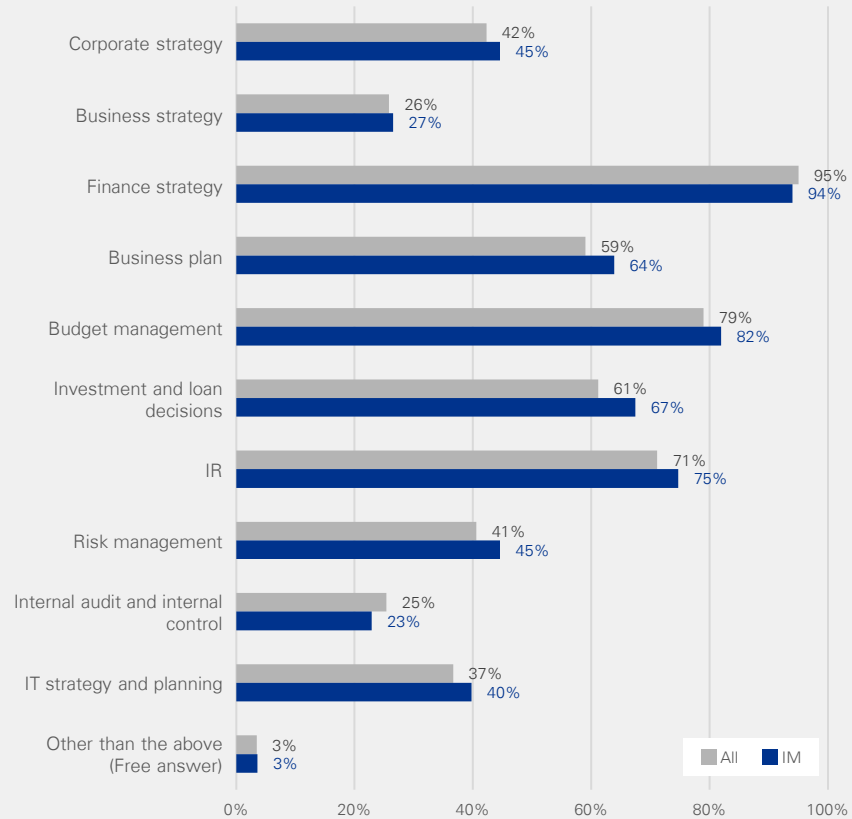


Q In the EU, mandatory requirements for external assurance of corporate sustainability reports have been proposed. What are your views on using assurance services from the viewpoint of improving the reliability of sustainability-related information?

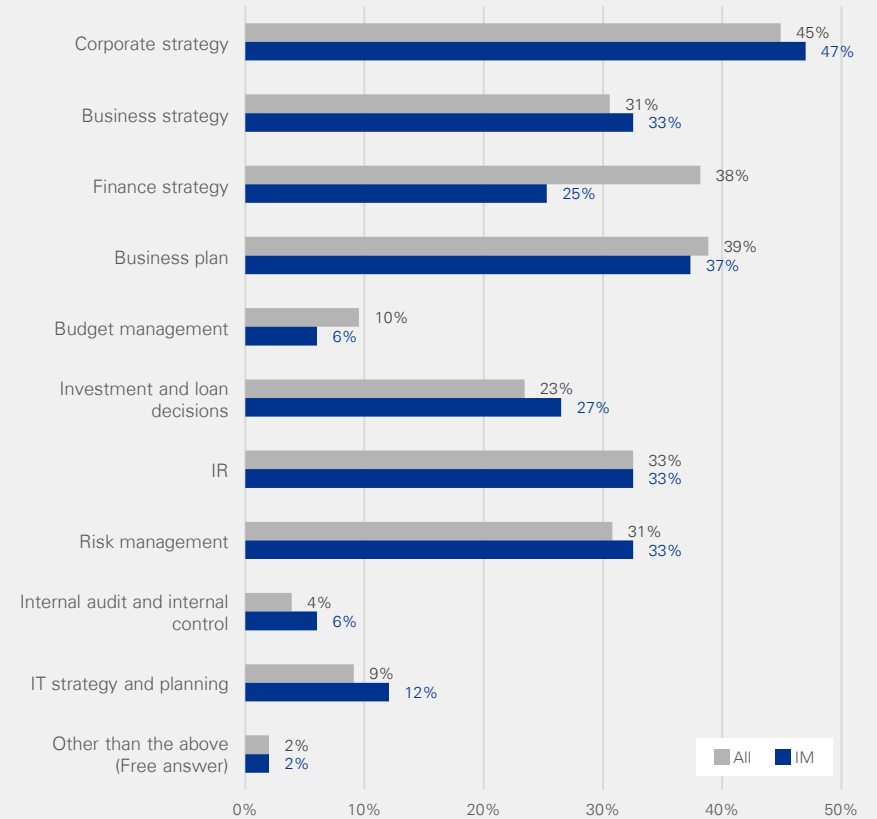


8.Accounting and Finance (1)

Please select all business area for which the CFO is currently responsible. (Multiple choice possible)

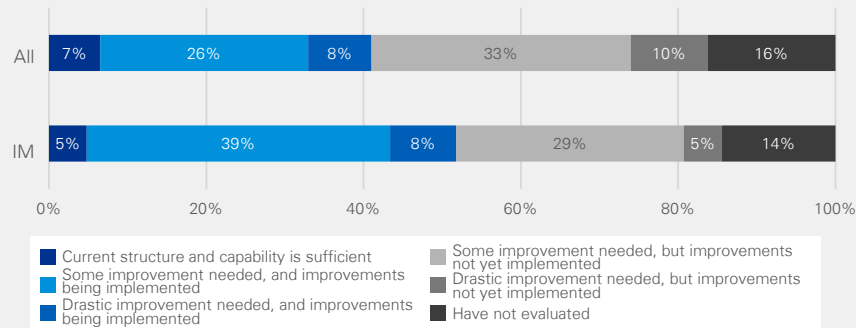


It is expected that management decisions driven by the linkage between financial and non-financial information will increase as the company makes progress towards SX. Of all areas that the CFO is responsible for, please select up to three areas that are considered to be of greater importance.

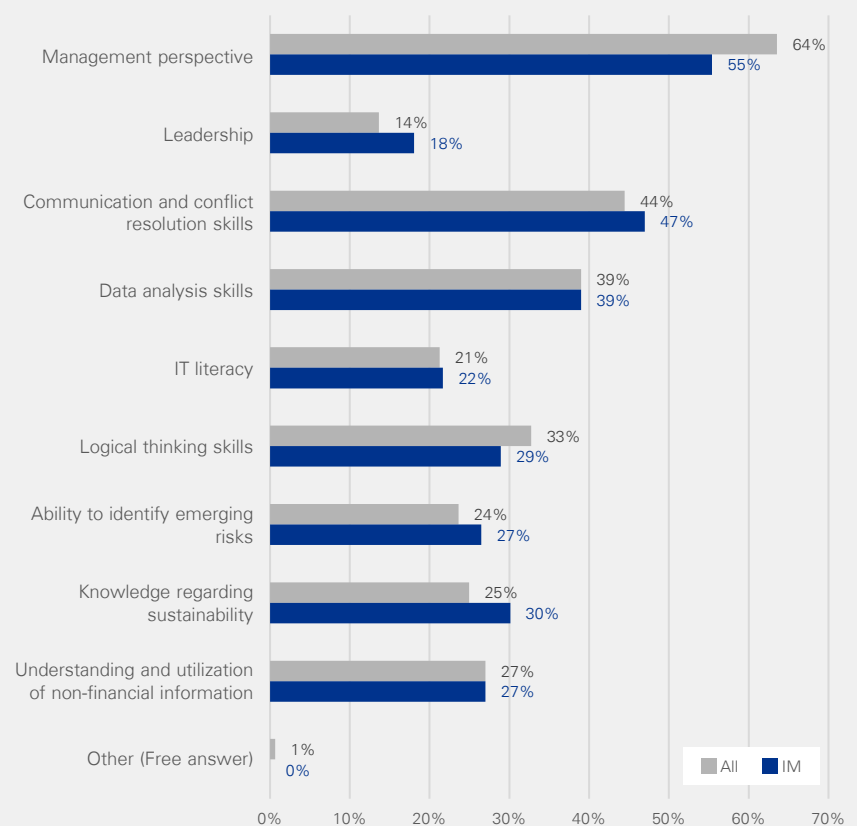


8.Accounting and Finance (2)

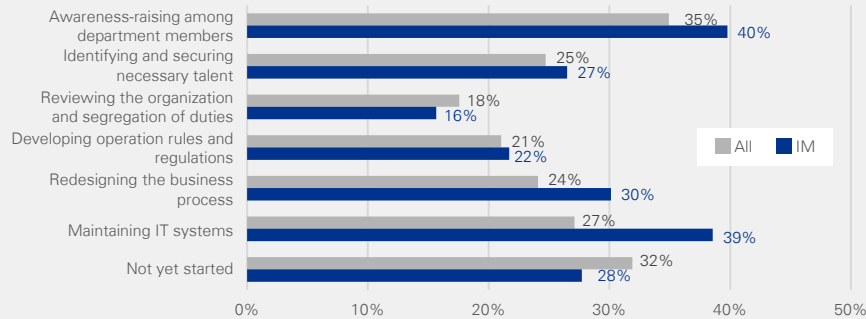
Please select the statement reflecting the current accounting and finance department structure and capability in terms of promoting SX in the future.



Please select up to three applicable items with regard to human resources and skills required for the accounting and finance department in the future.

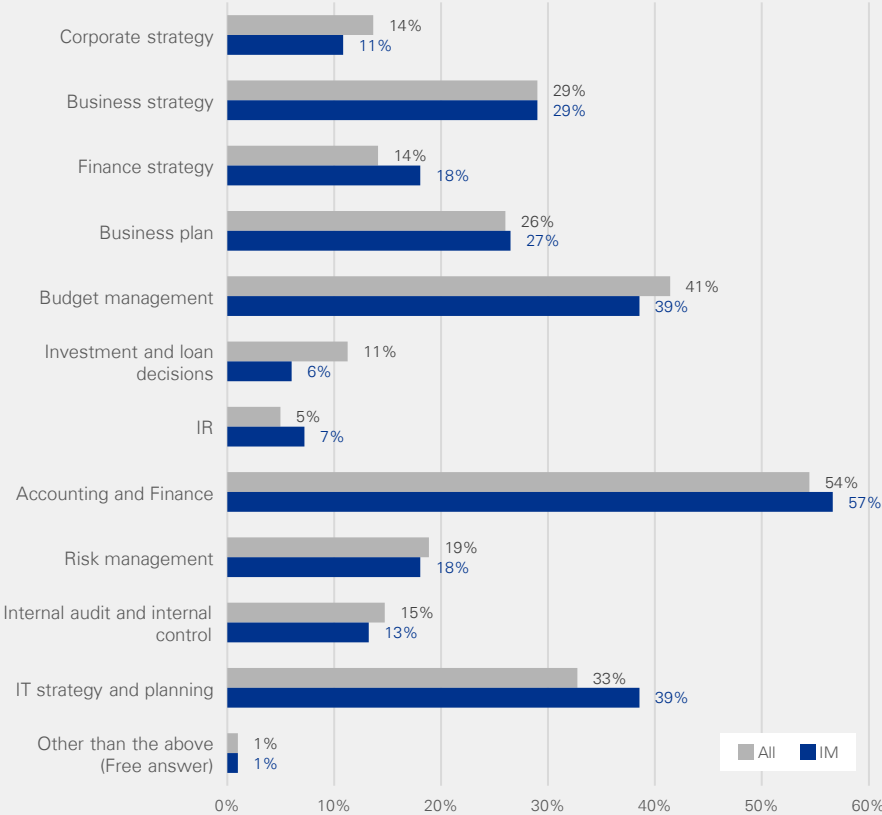


Please select the items that have been or are being addressed for improvement activities in the accounting and finance department for the promotion of SX.



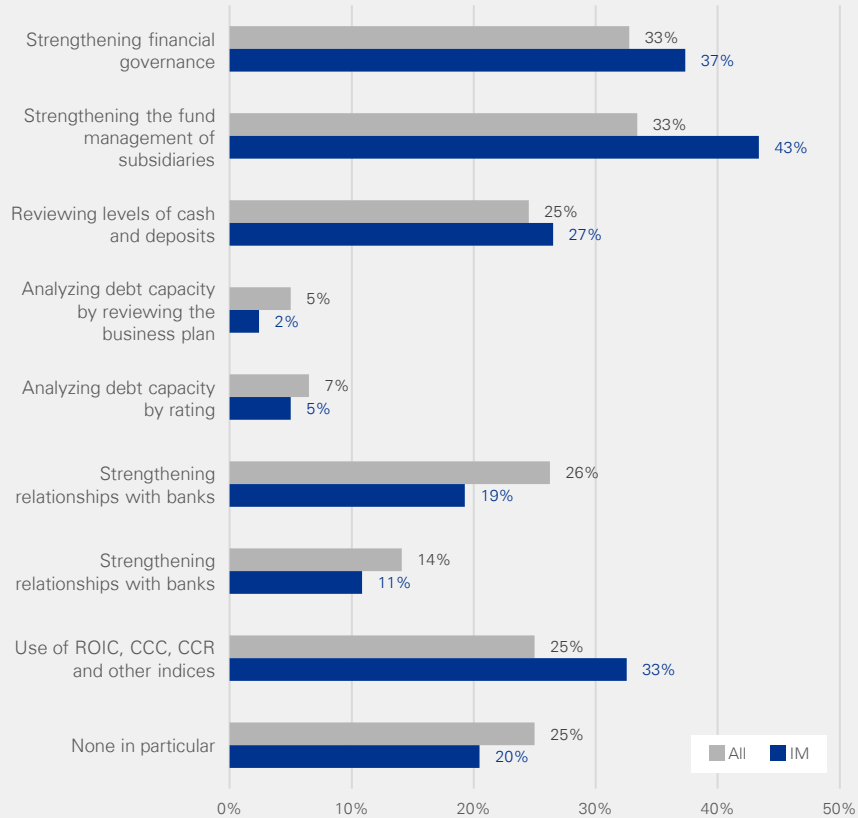
8.Accounting and Finance (3)

In view of SX promotion in the future, please select three areas for which you think digital utilization will be more necessary than ever before.

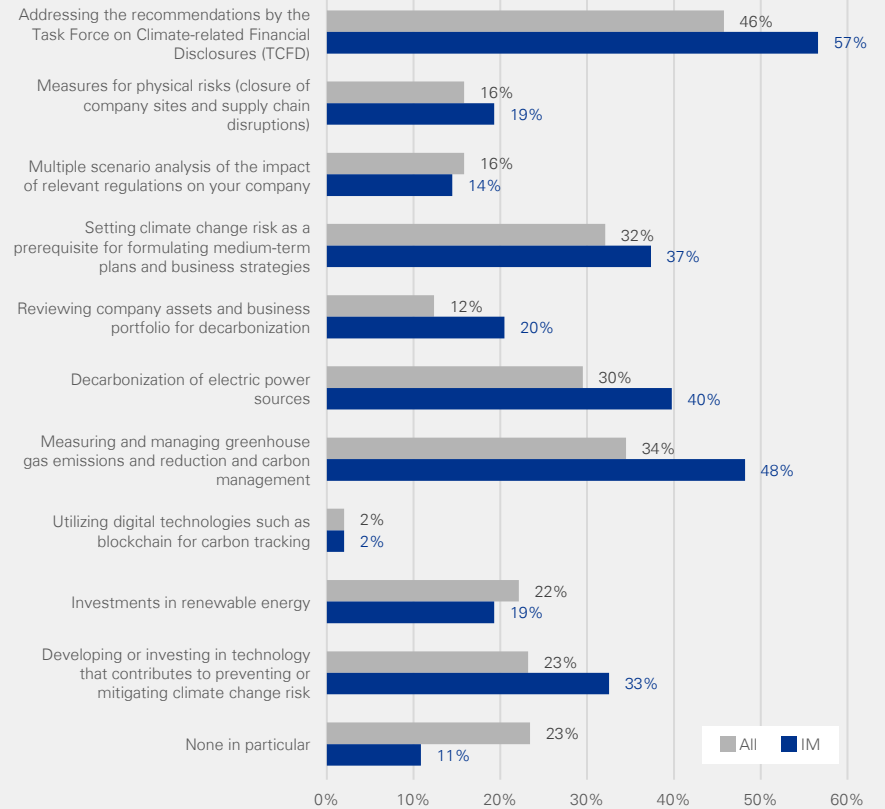


9.COVID-19

COVID-19 continues to affect businesses. Please select any measures that you have implemented or plan to implement with regard to corporate funding and "cash." (Multiple selections possible)

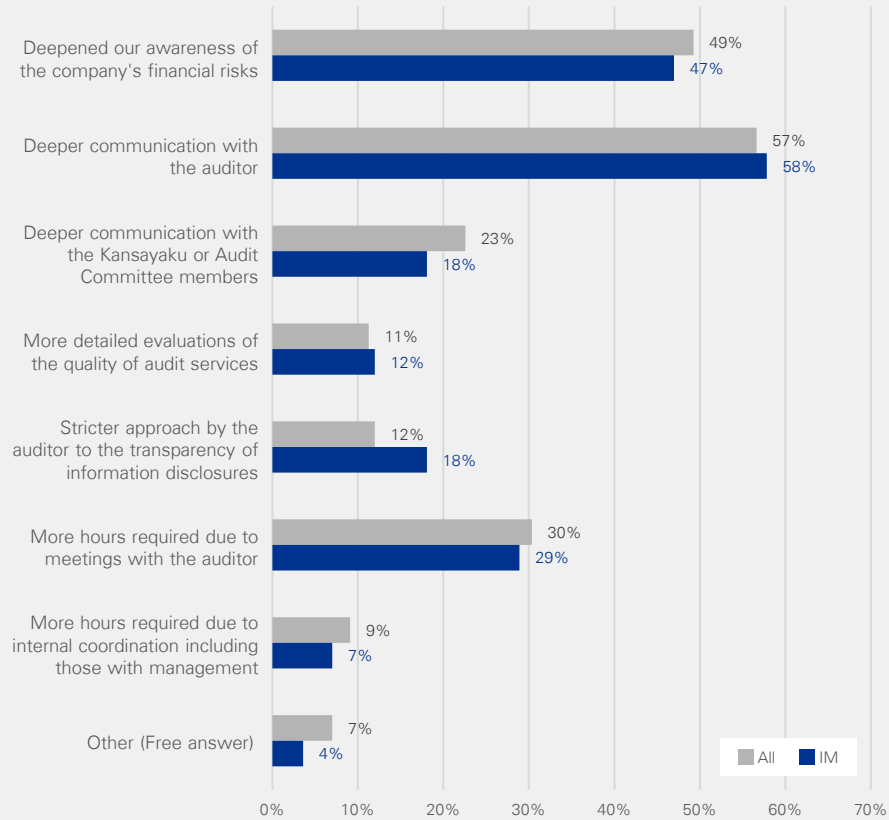


Please select all applicable measures that you have implemented or plan to implement in terms of dealing with climate change risk, which is receiving increasing attention from the market due to COVID-19. (Multiple selections are possible)



10.KAM introduction

Q What are the top three effects of KAM introduction you recognize?



Presentation of survey results as a ratio
 Survey results as a ratio are rounded to the nearest first decimal place and may not add up to 100 percent.



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