

2003 Porter Prize Winners

Suruga Bank Ltd. (regional bank)

Suruga Bank was established in 1895 as a regional bank in Numazu (population of 207,000, it is the fifth largest city in Shizuoka Prefecture), Shizuoka Prefecture (population of 3.8 million, it is the 10th largest prefecture out of 47 in Japan).

The bank was “sandwiched” between two large regional banks (*Yokohama Bank* in the east and *Shizuoka Bank* in the west), which forced the bank to pursue something different from these two.

In 1985, just before the deregulation of the Japanese banking industry, an influential management magazine reported the bank as one of the three worst banks in terms of instability. In 1988, the company started to focus on retail banking, especially mortgage loans, while Japan was still in the midst of the bubble economy. At that time, competitors were skeptical about retail banking because (a) marketing and processing costs of small loans to individuals were thought to be the same or exceeded those of big loans to institutions, and (b) retail business was thought to provide less value added as a result of price competition. Now, the company is recognized as a “role model” by other regional banks, and even mega-banks, for its retail banking strategy and operations.

The bank has developed numerous unique loan products. For example, there is one for those who cannot get mortgage loans for health reasons, waving payment if those who took out loans became sick or found themselves unemployed, or loans targeted for system engineers who changed jobs often, a target that banks in Japan usually avoided.

It also developed a unique sales channel, housing loan centers in residential areas that were under development around the outskirts of Tokyo. This strategy widened its market coverage in terms of geographic coverage. This was the very first attempt by a regional bank (restricted to operate within its region until deregulation in 1988) to differentiate itself from mega-banks by focusing on its local markets. It also formed an alliance with real estate developers in order to sell mortgage loans.

Its approval operation for mortgage loans was also unique, allowing approval in 24 hours in many cases instead of more than 10 days, which was the norm in Japan.

As a result of these activities, the bank’s personal loan ratio exceeded 64% in 2002, 30% more than the industry average.

The bank makes extensive use of one-to-one marketing and CRM. Its CRM allows *Suruga Bank* to engage in cross-selling, issuing non-secured loans to individuals within 40 minutes via ATM machines. It enjoys a much lower bad-loan ratio than the industry average.

In 1999, *Suruga Bank* started on-line banking, one of the first to do so in the industry. By providing a banking platform on the Internet, the bank allowed Internet service providers to settle accounts. On-line banking helped the bank to reach individuals outside of the Shizuoka region and improve its overall brand recognition.

The bank made significant trade-offs as well, such as closing “antenna” branches in Osaka and other metropolitan cities, as well as overseas offices, and choosing to close its businesses with corporate customers, such as its derivatives business. As a result, *Suruga Bank* enjoys an interest spread of 1.59%, which is more than twice the industry average.

Distinctiveness

Suruga Bank's distinctiveness stems from its clear focus on retail banking, as indicated by the fact that its personal loan ratio exceeds 64%. This percentage is 30% higher than industry average. Broadly speaking, its distinctiveness is manifested in two ways. For one, it is manifested in the way it accesses customers, namely through housing loan centers around the outskirts of Tokyo, the largest ATM network in the industry, on-line banking outlets, and other means. For another, it is manifested in the form of innovative loan products, especially mortgage loans, that are developed by front-line employees with the support of a detailed one-to-one CRM system.

The two unique mortgage loans mentioned above were, in fact, ideas developed by front-line employees who had close contact with real estate developers. In all, *Suruga Bank* has 26 different mortgage loan product offerings, each of which can be combined with four different types of insurance. A typical bank in Japan has anywhere from one to five such offerings. According to an internal survey, 90% of the mortgage loan customers at *Suruga* signed up for loans that were not available at other banks.

Suruga Bank has in place an on-line system that allows any employee in *Suruga Bank* to propose a new product idea. Any employee can access the “21st Century Explorer” site on its Intranet, which is the most often visited site at the bank, and propose ideas for a new product offering. The department or section to which the new idea is addressed must respond within 48 hours. As a track record, the usage of the “21st Century Explorer” site has consistently led to the commercialization of over 10 new products and the improvement of over 10 existing products in a half-year period.

Suruga Bank also has in place a system known as the “Junior Board” that allows front-line employees to develop a business plan over a one-year period and present it to the president. The president encourages Junior Board members to put their proposal into practice as quickly as possible, even if the plan has only a 65% chance of succeeding.

Supporting all these activities is a detailed one-to-one CRM system that has a large pool of information regarding each individual customer, including all transactions in the past. Access to such an information base allows front-line people to search for unmet needs of individual customers and propose means of satisfying those unmet needs in the form of new products/services. Access to the CRM system also allows them to accurately assess the capability of an individual customer to pay back the loan, leading to a much lower bad-loan ratio than the industry average. As a result of this well-developed CRM system, *Suruga Bank* can approve mortgage loans in 24 hours and issue non-secured loans within 40 minutes via ATM machines.

Innovation

- Housing loan centers with limited functions
- First attempt by a regional bank to widen its geographic coverage to the outskirts of Tokyo
- One of the first to provide on-line banking
- Created largest ATM network in the industry by forming alliances with convenience stores and post offices
- Automatic approval system that speeds up the approval process and reduces costs
- One-to-one CRM system covering the transactions of an individual customer across all fronts that leads to frequent new product innovations
- 21st Century Explorer system using the Intranet that allows front-line employees to propose new product/service ideas
- Junior Board that allows young employees to develop plans over a one-year period and suggest them to the president

Trade-off

- Chose to terminate or curtail its business transactions with corporate customers, including derivatives and M&A
- Closed branch offices in Aichi and Yamanashi prefectures as its on-line banking and ATM network developed
- Closed its overseas offices as well as its “antenna” branches in Osaka and other

metropolitan cities

- Chose to focus on unique mortgage loans that other banks did not offer

Superior Sustainable Performance

ROIC		Suruga Bank (percentage point)				
	5yr average Difference with the industry 0.8%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		0.8%	0.2%	0.4%	0.6%	0.7%

ROS		(percentage point)				
	5yr average Difference with the industry 25.9%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		21.7%	5.1%	5.2%	9.6%	14.0%

Compared with all the banks listed on the Tokyo Stock Exchange.

Seven-Eleven Japan Co., Ltd. (convenience store)

The company opened its first store in 1974 and has been the leader of the industry ever since. It has 10,000 stores that are open 24 hours a day, 365 days a year. 10 million customers visit their stores each year averaging one visit every other day. Average daily sales per store are JPY550,000 (USD5,000) which is the highest in the industry. (The industry average is JPY450,000, or USD4,090. ¹)

The company identifies its business as a “purchase agent for customers” and focuses on responding to diversified and changing market needs.

The company empowers store workers, even part-timers, to order merchandise in response to local needs. It not only invests in POS systems, but also in educating store managers on hypothesis building and testing. Store managers and staff often have conversations with customers in order to find out local events. Then they can build a hypothesis of selling products and order the appropriate items. For this purpose, the company invites 2,000 field counselors to its headquarters every week, which costs the company JPY3 billion a year.

The company utilizes its extensive retail data for team merchandising development tie-ups of original products. The company started selling prepared foods (“fast food”) such as rice balls and lunch boxes, which now consists of 30% of their sales. The manufacturers produce these perishable products based on a cooked-to-order system. The company expanded its joint development to other items such as instant noodles, canned coffee, and cosmetics. As a consequence, “original products” make up 50% of their sales. Their original products are different from private brands in their pursuit of higher quality and a thicker margin. The company offers more than 4,000 new items to franchise stores every year and it adds 80 new items to the list every week.

The company understands real time inventory of each SKU. Combined with hypothesis building and testing regarding customer needs, 70% of its SKUs will be changed within a year. It also keeps low inventory and an inventory turnover of 41.9 times, which is much higher than its parent company, *Ito Yokado* supermarket (12.2 times).

The company developed efficient logistics by opening new stores in a geographically concentrated way (“area-dominance strategy”). Even though it has the largest number of stores, the geographic area covered is less than its major competitors (it has stores in only 32 out of 47 prefectures).

¹ Average of the leading five convenience store chains, except the company, in February 2003. (Source: Seven Eleven Japan Co., Ltd.)

Distinctiveness

Seven-Eleven has the distinction of recording the highest sales per day and sales per store in the industry. It is clearly a role model of operational effectiveness, which is brought about by its inventory turnover of 41.9 times, its highly efficient logistical system, its state-of-the-art IT system, and its area-dominant franchising system, among other things.

Its distinctiveness, however, is also attributable to three broad activities within the value chain, namely (a) new product development, (b) merchandising, and (c) sharing of know-how.

In terms of new products, *Seven-Eleven* offers a total of 4,000 or so new items a year and adds some 80 new items to the list every year. Of these, about half are “original products” co-developed with outside manufacturers in what is known as the team merchandising development scheme. In other words, 50% of the products sold at a *Seven-Eleven* store are original products that cannot be found elsewhere. These products include noodles, boxed lunches, rice balls, bread, confectionery, drinks, beer, toys, and a variety of other items.

In terms of merchandising, the company empowers store personnel to order and replenish merchandise in response to weather conditions, time of the day, local events, local needs, POS data of past sales, changes in customer profile, and other relevant information. Even part-time workers, who could number 20 per store, participate in this process. Every ordering and replenishment decision is made by referring to the real-time, item-by-item inventory data system, which can instantaneously determine the fast-moving and slow-moving items. Store personnel are also encouraged to engage in hypothesis building and testing by asking themselves “Which kind of customers will buy what kind of products at what point in time?”

Sharing of know-how is accomplished in a very unique manner within *Seven-Eleven*. It assembles 2,000 field managers in charge of store operations and store development from all over Japan to meet in Tokyo, along with executives from headquarters, every Tuesday for what it calls the FC (Franchise) Meeting at a cost of JYP 3 billion. Assembling the top 2,000 people every week in Tokyo and having a face-to-face meeting may seem to run counter to a company known for its operational efficiency, but the company firmly believes that is the best way to communicate with each other and share know-how.

Innovation

- Efficient logistics system

- First company to use the POS system in the industry
- Co-development of a real-time inventory management system with its partners
- Team merchandising development scheme
- Hypothesis building and testing approach towards ordering and replenishment

Trade-off

- Avoid price discounting and maintain willingness to pay
- Avoid increasing assortment and concentrate on a few fast-selling items
- Avoid increasing number of stores at the expense of decreasing efficiency in logistics
- Avoid increasing the size of the store beyond the control of the store manager and part-timers
- Avoid entering businesses such as transportation, product development, database marketing, or IT that are not at the core of the convenience business

Superior Sustainable Performance

Seven Eleven Japan
(percentage point)

ROIC	5yr average Difference with the industry 16.1%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		14.6%	17.3%	16.2%	15.3%	14.3%

(percentage point)

ROS	5yr average Difference with the industry 38.3%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		36.0%	39.0%	39.2%	39.4%	36.1%

Compared with convenience stores and supermarkets in Japan.

Trend Micro (antivirus software services)

The company is the third largest antivirus software vendor in the world, following Symantec and Network Associates. The antivirus market grew 31% in 2002 over 2001, and the company grew 37%.

The company is unique in the sense that it focuses on antivirus software only, while the top two competitors operate in other segments in the network security industry, including firewall and intrusion detection systems. They provide integrated software and services as a “security suite.” This strategy appeals to middle- to small-sized companies and individual customers who emphasize easy handling over performance. However, a one-package strategy slows down product development and allows the other companies to stay at the leading edge in each industry segment because they have to expend extra effort to share codes among different software, for example. Also, it requires spending more on mass-marketing in order to attract consumers.

The company believes that to stay at the top, it should focus completely on the segment because the change in virus technology is very rapid. Also, developing antivirus software is extremely complicated. It has to work against all the viruses in history and should be compatible with every operating system. Viruses can emerge from anywhere in the world and spread rapidly. Antivirus companies have to coordinate their activities across borders in order to respond within a short period of time. The company has more than 1,800 employees in 25 countries and virus response labs in six countries. No competitor has such an international reach. The company leads Symantec by a wide margin in response time to new viruses.

The company has introduced a service that will expand the coverage over a virus's outbreak life cycle that includes prevention. It employs an alliance among category leaders instead of internalizing those capabilities like Symantec does.

The company targets large corporate customers who appreciate high performance over easy handling or brand name. Even though it started later than its competitors, it has successfully made sales to 1,000 global companies in the U.S. and Europe. In Japan, it has more than a 90% of share in the government market.

The company's high-end focus is a little bit different in Japan. It sells to middle- and small-sized firms, as well as to consumers. Yet, it does not think that this is in contradiction to their high-end focus. It has brand recognition in its home market so it does not have to engage in mass marketing to approach consumers. Due to the economics of software products, the company believes that simplifying products that were originally developed for large corporate customers does not have to require much

additional cost. For instance, there is no additional production line, nor significant inventory costs. They need different channels, but the company has been developing that through system integrators (the major channel in Japan) rather than direct sales so that it can efficiently approach numerous middle- and small-sized companies.

Distinctiveness

Trend Micro distinguishes itself from its overseas competitors (Symantec and Network Associates) by focusing on anti-virus software and services. It has the No. 1 market share in the world in Internet gateway antivirus software (39.4% in 2002, twice that of Symantec, the runner-up at 20.9%). It also has the No. 1 share in mail server antivirus software (20.9% in 2002, followed by Symantec at 20.5% and Network Associates at 18.4%). To achieve these results, the company differentiated itself on two value chain activities, namely technology development and customer service.

From a technological point of view, the company realizes that developing antivirus software is extremely complicated. It has to work against all the viruses in history and should be compatible with every operating system. Therefore, *Trend Micro* has its engineers working full time in six countries, including Japan, U.S.A., Taiwan, Germany, Philippines, and China, in its virus response labs. Its product development is conducted mainly in Taiwan, which boasts a large number of Ph.D.s in general.

Customer service is the other area in which *Trend Micro* has a distinctive advantage over its competitors. Viruses can emerge from anywhere in the world and spread rapidly throughout the world. Therefore, the company has spread its top executives, engineers, and support staff throughout the world offering services 24 hours a day, 365 days a year. No other rival virus company has the international reach of *Trend Micro*. Its main virus response center is in Manila, where 250 engineers are stationed. It leads Symantec by a wide margin in terms of response time to new viruses. The company guarantees delivery of inoculations against major viruses in less than two hours.

Innovation

- First company to offer Internet gateway antivirus software. Received patent in the U.S.A. in 1996
- It has created a “stateless” transnational organization, with its financial headquarters in Tokyo, its product development in Taiwan, and sales in the Silicon Valley. Steve Chang, CEO of the company, is constantly visiting its 20-plus sites around the world.

Trade-off

- Not entering other segments in the network security industry, including firewall and intrusion detection systems. Its competitors, Symantec and Network Associates, offer a “security suite” of integrated software and services
- Formed alliance with outside category leaders rather than internalizing other security capabilities, such as prevention, on its own
- Emphasizing high performance at the expense of easy handling
- Not expending much on mass marketing in order to attract consumers through brand recognition

Superior Sustainable Performance

ROIC	Trend Micro (percentage point)					
	5yr average Difference with the industry 13.9%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		17.2%	7.5%	8.1%	3.7%	2.0%

ROS	(percentage point)					
	5yr average Difference with the industry 27.6%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		28.3%	26.3%	30.1%	27.1%	20.0%

Compared with software service providers in Japan.

Shimano Inc., Bicycle Parts (bike parts manufacturing)

Shimano is a clear-cut global industry leader in the bicycle parts business. In 1984, the company integrated independent parts and provided systematized/integrated components. In other words, the company changed the bicycle's product architecture from a modular to an integrated architecture. Systematization of components made bike riding easier for riders, and assembly and adjustment easier for bike shops, so much so that *Shimano's* system has become the de facto standard of the industry.

The company has been developing its own sales forces overseas since 1965 so that they can easily explain their innovations, train their mechanics, and determine end-users' needs. They visit bike shops ("Dealer Caravans") and invite bike shops for "Dealer Presentations," which sales and marketing personnel, as well as designers and quality control people join. The company also dispatches 14 employees every year for three months to work at bike shops overseas in order to understand those businesses. Sponsoring road races and mountain bike championships help the company employees to understand the end-users, as they conduct most of the activities (such as reception and even parking guide) for the races.

The company introduces new models every year and has successfully improved its performance. It also responded to emerging market needs and successfully created a new market segment for mountain bikes (1986). Sponsoring races that bear the company's name has helped the company to nurture the sport and expand the market. As a result, the company covers almost all the market segments from race, mountain bike, street, and mass market to children. The company is trying to expand the bike market further by proposing new styles of bikes to the assembly makers. It is now developing an automated transmission that makes riding bikes much easier and more comfortable for children and elderly people.

Two other global competitors who have also adopted a system-components strategy are trying to emulate *Shimano* but are struggling. *Campagnolo* (Italy) has been focused on the race market. They tried to enter the mountain bike market at one time, but failed. Another competitor, *Sram* (UK), had been focused on the shift-lever parts compatible with the Shimano-standard, but changed its strategy to become a system-component provider by increasing the kinds of parts it develops. *Sram's* financial result worsened as the company struggled with its strategy change.

Distinctiveness

Shimano controls anywhere from 60% to 70% of the world market for

derailleurs, speed hubs, brakes, and other components for racing bicycles. Its distinctiveness stems from the fact that the company integrated these different parts and created a modular component system for bicycles. *Shimano's* success is based on two activities in the value chain that differentiated the company from its competitors, namely technology development and marketing.

Shimano has sought the most advanced technology by concentrating its R&D on the high-performance segment of the bicycle parts industry and creating an integrated, modular component system that was a win-win for all. Systematization of components made bike riding easier for riders and, at the same time, made assembly and adjustment easier for bike shops. By the mid-1980s, the so-called *Shimano* system became the de facto standard for the industry. In more recent years, it has been engaged in a collaborative effort with other components manufacturers and bike manufactures to propose futuristic "concept bikes."

The company also sought continuous improvement, introducing new models every year and successfully upgrading its performance. It also responded to emerging market trends and successfully created a new market segment for mountain bikes, which it introduced in 1986. Mountain bikes were based on high-tech, rugged, shock-absorbing gear changers. *Shimano* currently commands a high market share in this product category as well.

Shimano's marketing efforts have been closely tied to the development of the integrated component system. It has been dispatching its sales people to the U.S. and Europe since the mid-1960s to explain the innovations contained in the *Shimano* system, as well as to train dealer mechanics. The Dealer Caravans and Dealer Presentations that *Shimano* organizes help to establish strong loyalty from bike shops and end-users. To further solidify its positioning within the high-end market, it has been engaged in the sponsorship of road races, mountain bike championships, and professional racing teams, and the dispatching of race mechanics and racing judges.

Innovation

- Developed an integrated component system which became the de facto standard within the high-end bicycle market
- Created the mountain bike and developed its market overseas

Trade-off

- Not pursuing the maximum functionality of an individual part
- Not developing and producing bike parts, such as tires and saddles, that do not

improve the performance of bikes through systemization

- Not offering independent parts
- Not offering finished bicycles
- No marketing activities toward the mass market segment on its own
- No OEM production

Superior Sustainable Performance

Shimano Bicycle Components
(percentage point)

ROIC	5yr average Difference with the industry 16.3%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		17.5%	11.0%	16.2%	19.7%	18.0%

(percentage point)

ROS	5yr average Difference with the industry 14.3%	Difference with the industry average in each year				
		2002	2001	2000	1999	1998
		16.2%	11.7%	15.3%	17.1%	14.9%

Compared with bike component manufacturers in Japan.

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