

## **Porter Prize Winners 2005**

December 1, 2005

Prepared by Porter Prize Organizing Committee

### **Single-business Companies**

#### **Bandai (toys and games manufacturing)**

Bandai established a unique strategic positioning in the toy industry as a “character merchandiser.” The company marketed characters such as Power Rangers, Digimon, Gundam, Tamagotchi, Pokemon (in selected product categories and regions), Dragon Ball and Sailor Moon, among others. It is a clear leader of the character business in Japan, managing more than 150 characters currently.

Almost three-quarters (73.6%) of Bandai’s consolidated sales are derived from characters. These characters are marketed in the form of scale models, capsule toys sold through vending machines, card games, video games, apparel, and personal care products. In 2004, it had 88% market share in the “character” scale model market and 46% market share in the “general” scale model market; 65% share in the capsule toy dispenser market, 35% share in the card game market, 36.4% share in the candy toy market, and 65% share in children’s character apparel market.

In general, the toy industry is stable, but shrinking and becoming less profitable due to the decline in the number of children and increasing pressure from discount retailers. The character toy business is a distinctive industry segment where one big hit could bring in more than \$100 million in sales, but where hit characters are extremely difficult to create on a continuous basis. Although Bandai successfully achieved stable growth and high profitability, its competitors -- such as Tommy, Takara, and Sunrio -- who tried to copy Bandai experienced large ups and downs in sales and were in the red in at times.

In terms of the value chain, the company’s uniqueness is due to its ability to source characters, develop character products, and market/sell these products. In terms of sourcing characters, Bandai has negotiating power vis-à-vis copyright holders because it has access to various product forms/categories through which characters would be promoted and sold. Bandai, however, is not only dependent on

licensing characters from outside copyright holders. The company also develops its own characters and becomes a copyright holder on its own right, letting in-house characters co-exist with “out-sourced” characters.

In terms of developing character products, Bandai advises copyright holders and internal designers what design is most suited for production. It also advises copyright holders/internal designers which product form/category will hold the best potential for stimulating the market and the right timing to launch the character products. Bandai is able to synchronize product development, given the large number of product forms/categories it has on hand as well as the large number of promotional vehicles it has on hand. Bandai also has the largest toy wholesaler in Japan as a subsidiary, which enables it to gain access to useful retail sales information, which serves as a basis for new product introduction decisions.

In terms of promotion, Bandai’s characters are incorporated in a large number of product forms/categories and are sold in a wide variety of retail outlets (e.g., camera stores, which sells the large number of the most popular character items; video game shops; apparel stores; etc.). The company uses this scale and configuration merit to sponsor a number of TV programs in which it broadcasts commercials of its characters/products.

The key to Bandai’s success is coordination management. It has to coordinate its activities both vertically (from design to manufacturing to promotion) and horizontally (across product forms/categories from scale models to video games to apparel items). In order to coordinate all these activities, the company introduced an organization unit called “Media Division.” The term “media” is used here to denote copyright holders, TV program developers, TV stations, advertising agencies, and the like. The company also created a strategic position called “Character Manager,” who is in charge of coordinating the activities for each character and is responsible for the overall profitability of each character.

Distinctiveness: Successfully develops and maintains “stable” characters (e.g., Power Rangers, Gundam), which make up 50% of the company’s sales. Successfully coordinates its merchandizing activities.

Innovation: Character merchandizing system that allows extensive coordination of character products.

Trade-off: Does not take an “exclusive” strategy for licensing-in and licensing-out characters so that it can keep its control over character source and character sales media selection.

Because the company's major customer segment is children, it does not license the characters to Pachinko and pornographic businesses.

**Note:** It should be noted that Bandai merged with NAMCO (video game developer/manufacturer) this year, which created a holding company called NAMCO BANDAI Holdings. As part of the new organization, Bandai is an independent company responsible for Toys and Hobby.

Because of this new development, we created two sets of financials for Bandai. The first (1a) is the post-merger data, which includes Nintendo and NAMCO as competitors. The second (1b) is the pre-merger data of Bandai (i.e., without video game competitors). The second set of data is the more relevant one for us since Bandai applied to the Porter Prize before the merger and the financials are for the years (2000 to 2004) that predate the merger. For the same reasons, we classified Bandai into the "single-business company" category, although it is currently one of the independent companies of the holding company, NAMCO BANDAI.

### **Taiyo Yakuhin (pharmaceutical manufacturing – generics)**

Taiyo Yakuhin (Taiyo) is the leader of the Japanese generic drug manufacturing industry, which accounted for 16% of all the ethical drug market in Japan. The company, which is almost double the size of the runner-up in generics in terms of sales, describes itself as "Takeda of generics" (Takeda Pharmaceuticals won the Porter Prize in 2002). Taiyo doubled its sales in 5 years, supported by the introduction of new products at a pace faster than its competitors. The company's operational profit per employee was 20 million yen, while the second and third largest generic makers, Towa's and Sawai's was 3 million yen each.

Taiyo employed a low cost strategy. Although Taiyo was the No. 1 company within the generic drug manufacturing industry in terms of sales, it had only one-third the number of employees compared to No. 2 Towa. This gap was due mainly to the smaller number of MRs (58 of them) relative to other generic manufacturers. The company also employed laboratory technicians as part-time employee after its R&D center moved from the suburb area of Nagoya City to the center of the city, where it was able to recruit female engineers who, until then, stayed home. Taiyo also was a low-cost producer, despite the fact that the manufacturing line of the generic industry, in general,

had a low utilization rate since the production volume of generic drugs was much smaller than that of a patented drug.

The company solved this problem by producing the expected annual sales volume of a drug all at once. It created a production schedule that produced the same form of drug one after another (e.g., same size of tablet) in order to reduce the down time of the manufacturing line. Furthermore, in order to keep the manufacturing line up and running, Taiyo manufactured drugs for other drug makers.

Taiyo made a conscious effort to support small and medium-sized wholesalers. For one thing, these wholesalers enjoyed one-stop shopping of Taiyo's product line, which was the broadest in the generic drug industry. The company offered 415 products on its catalogue, compared to 395 for Towa and 218 for Sawai. In addition, the company reduced the inventory carrying cost on the part of the wholesalers by keeping the ownership of the products until they were sold to the hospitals. By doing so, it alleviated the financial burden of small and medium sized wholesalers, to whom inventory carrying cost was a big cost item. Through these activities, Taiyo successfully organized more than 200 small and medium sized wholesales to become its sales agents. (In Japan, big wholesalers were not interested in carrying generics since they could not make as much profit as with patented drugs.)

Taiyo alleviated the uneasiness on the part of hospitals to purchase generics in a number of ways. For one thing, it provided an abundant amount of product and safety information on its Internet site. Second, it developed a supply chain management system (patent pending) that could tell which lot was sold to which hospital so that when any unexpected side effects are discovered, it can inform its customers immediately. Third, it asked its selling agencies to keep 1.2 to 1.5 months of inventory in order to ensure a stable supply of drugs.

Within the value chain, Taiyo's strength can be seen in R&D, manufacturing, and sales/marketing and service. In R&D, Taiyo excelled in developing drugs that were easy to handle and easy to swallow. For example, Taiyo had the fourth largest number of patent applications (following Takeda, Astellas, and Eisai, all three of whom are prescription drug manufacturers) for tablets that melted quickly in the mouth without water. In manufacturing, Taiyo excelled in manufacturing injection type drugs, which were more difficult to produce than oral type or external application type drugs. This capability allowed the company to sell manufacturing services to 50 companies, making it the leading outsourcing service provider in drug manufacturing in Japan. In sales/marketing and service, Taiyo succeeded in making abundant product information available on the Internet, as opposed to the industry norm of using MRs. Taiyo also

succeeded in building an effective and loyal cadre of sales agents by offering favorable conditions (e.g., eliminating inventory carrying cost). It also succeeded in implementing a tracking system that reaches hospitals when side effects occur.

Distinctiveness: Leading maker in Japanese generic industry with broadest product line

Provides one stop shopping for its sales agents.

Low cost position

Sequential production schedule to alleviate manufacturing down time

Innovation: Introduced pay-for-sale system for sales agents.

Trade-off: Do not have large number of MRs.

## **Divisions of Multiple-Business Companies**

### **Benesse, Education (education)**

Benesse was established in 1955 in Okayama Prefecture under the name Fukutake Publishing, publishing junior high school education materials. Today, Benesse (corporate name changed in 1995) is the leading provider of correspondence courses in Japan.

The Education Group within Benesse, which accounts for 63% of corporate sales, offers individualized off-campus educational service through correspondence courses to children of all ages. For children six months to six years old, it delivers picture books that support mothers to help infants develop under the “Kodomo Challenge” brand. For elementary school, junior high, and senior high school students, it offers correspondence courses under the “Shinken Zemi” brand. It offers a total of 18 courses covering all age groups.

Enrollment in its correspondence courses totaled 4 million students in 2005, up 4.7% from a year earlier. One of the unique features of Benesse’s Education Group (Benesse hereafter) is the fact that it enjoys exceptionally high customer re-signing rate when students move up a grade (e.g., from First Grade to Second Grade within the elementary school) and when students move from one school level to the next (e.g., from elementary school to junior high school).

Benesse’s strategic positioning as a continuous supporter of everyday study is unique in Japanese educational service industry, which has typically focused on

entrance exam preparation. This positioning comes from the company's corporate name, Benesse (live well) and its mission to help people's self-improvement desire. It provides career information and consultation to elementary school and junior high school students so that students would start thinking about their future broadly at an earlier stage of their lives. It targets those students who go to public schools and it reaches them through correspondence courses.

Another point of differentiation for Benesse vis-à-vis its competitors is "customization at reasonable prices." Developing products and services tailored to individual needs (i.e., customization) runs counter to the traditional approach within Japanese public education. The norm in the past has been to offer a standardized nationwide curriculum using standardized textbooks using the same teaching methods.

To realize customization, Benesse has developed and accumulated a rich stock of teaching materials, for one thing. For example, it has a stock of 2,000 teaching materials for the English course for 1<sup>st</sup> year senior high school students and 1,000 teaching materials for the Mathematics course for the same students. Second, customization is realized through extensive use of information and communications technology. Individualized needs are programmed based on a student's level, textbook used at his/her school, the school he/she goes, and his/her future plan. The appropriate teaching materials for a particular student are automatically printed out and packaged individually. Third, Benesse also customizes feedback to the answer sheets send by students through the use of "aka-pen-sensei" (literally translates to red-pen-teachers). These part-time teachers, who are typically housewives with high education, work from home to grade and literally pencil in advices and encouragements on the answer sheets for correspondence courses. A high-touch approach, for sure. Finally, Benesse provides individualized feedback to high school students who take the Shinken Simulated Exam, which is a simulated entrance exam that 81% of all the high schools in Japan take. Here, Benesse takes the high-tech approach utilizing its advanced information and communications technology.

In addition to being individualized, Benesse's offerings are reasonably priced. For example, the monthly fees are 1,487 yen for pre-schoolers, 2,431 yen to 4,472 yen for elementary school students, 4,982 yen for junior high students, and 7,211 yen for senior high students. Expenses are lower than competitors for a number of reasons. Unlike cram schools, it does not have to employ superstar classroom teachers, who command a premium pay. The high-touch "aka-pen-sensei's" are part-timers who are willing to work for much less pay than full-time employees. Benesse also achieves low cost by automating customization of teaching materials, printing, packaging, and delivering.

Yearly subscription and high re-signing rates allow the company to avoid over-production. It centralizes teaching material development and marketing activities and does not have local sales representatives. It does not pay for rent for classrooms.

As “Can Japan Compete?” pointed out, the Japanese education system is in need of fundamental reform, not only at the higher education level but at the basic education level as well. Due to mounting pressure, the Education Ministry (MEXT) sought to create an education environment that reduced pressure on elementary school students. In 2002, classroom time and course content were both reduced, setting aside more time for comprehensive study that put more emphasis on hands-on learning. Three years later, there is a mounting concern that the academic abilities of Japanese children were declining. Two survey results – one by OECD called Program for International Student Assessment (PISA) and the other by the International Association for the Evaluation of Educational Achievement called Trends in International Mathematics and Science Study (TIMSS) – showed that Japan’s ranking in 2003 fell substantially compared to 2000. This prompted MEXT to declare that future education policy would put more emphasis on raising academic abilities of children.

Given this backdrop, what Benesse has been able to achieve -- an exceptionally high re-signing rate backed up by customized teaching materials that meet subscribers’ needs; high attachment to Shinken Zemi developed by high-touch communication with aka-pen-sensei; individualized communication from the call center to encourage those subscribers who do not return the answer sheets; earning superior, sustainable profitability by charging reasonable prices when Japan is facing a rapidly falling birthrate – may provide a glimpse of hope for the future.

Distinctiveness: Focuses on individualized educational service through correspondence courses.

Achieved extremely high customer re-signing rate.

Innovation: Developed an everyday study support system under which individualized high-touch educational service (e.g., utilizing “aka-pen-sensei”) is possible at reasonable prices (e.g., utilizing advanced information and communications technology).

Trade off: Do not offer in-class teaching as typically done at cram schools because it cannot offer individualized service, it has limited reach, it is labor intensive and it requires expensive rent.

Do not sell teaching materials at bookshops because it will make production planning and inventory control difficult in addition to the

sales margin it has to provide wholesalers and bookshops.

Do not have local sales representatives, who usually develop new customers, listen to customer needs, and deliver products. Benesse listens to customer's voice at the call center, develops new customers through direct mail and TVCF, and delivers from the two logistics centers.

### **Horiba, Engine Measurement Instruments and Systems (measurement and analyzing equipment)**

Engine Measurement Instruments and Systems is one of the four business segments of Horiba, a Kyoto-based company founded in 1945 by Masao Horiba. It represented 29.2% of Horiba sales in 2004. The three other business segments consist of Analytical Instruments and Systems (30.8%), Medical/Diagnostic Instruments and Systems (20.3%), and Semiconductor Instruments and Systems (19.7%).

This business segment (hereafter referred to as the Engine Division) provides analyzers and turnkey systems for everything from emissions certification to R&D for engine development. Although about 350 different product types are sold in this field, Horiba's Engine Division mainstay product consists of exhaust gas analyzers, which represent 90% of division sales. These analyzers are used worldwide by automotive and motorcycle manufacturers for R&D and quality control, as well as by engine manufacturers and automotive maintenance repair centers. In addition, Horiba's exhaust gas analyzers have been adopted by many of world's regulatory exhaust gas certification agencies and laboratories. In addition to complying with clean air regulations, which are becoming stricter every year, these analyzers are indispensable to automotive and other manufacturers in developing fuel-efficient cars -- including hybrids and diesels -- which are increasingly becoming a key source of differentiation within the industry.

By focusing on exhaust gas analyzers (also known as emission analyzers) for more than 40 years, Horiba became a clear winner in this market segment vis-a-vis its competitors, who opted to develop general-purpose environmental analyzers. As a result, Horiba now enjoys 80% market share of the world market for automotive emission analyzers. (Its remaining competitor is Austria's AVL.) Horiba's focus on exhaust gas analyzers contributed to its high profitability since the main customers of the general environment analyzer market are the national and local governments, whose willingness-to-pay is substantially lower.

Although Horiba's strength lies in exhaust gas analyzers, the Engine Division

offers a total system to run experimentations from gas sampling to analyzing, which has been automated, requiring only one operator to run a laboratory unit. Included in the line-up are such products as chassis dynamometers, automatic driver systems, onboard emission measurement systems, portable emission analyzers, and fuel cell testing units, to name a few. As fuel efficiency and environmental friendliness are becoming important sources of differentiation, all of the major automotive manufacturers (with the exception of GM) are adding more advanced laboratory units from Horiba.

In this market, large customers are globalizing but differences in regulatory and customer needs across region remain. To address this “glocalization” issue, Horiba standardized its measurement system so that customers could take comparable data across borders; at the same time, it localized the software to manage experimentations and gas sampling to fit regional needs.

To address the glocalization issue, it also developed a unique product development unit called Global Product Planning Group (GPPG), which is one of Horiba’s “virtual functional headquarters.” First of all, members of GPPG choose which activity within the value chain should be managed globally and which should be managed locally. Next, for an activity to be managed globally, different tasks within the value chain are assigned to a country that can most appropriately carry out the task. For an activity to be managed locally, the local country manages the entire value chain.

Marketing and sales activities of the Engine Division have traditionally been handled by trading companies. In 2002, it took this value chain activity in-house and adopted a direct sales business framework both in Japan and overseas. Switching to direct sales allowed Horiba to receive direct customer feedback as well as gain better insights into the future (e.g., non-gasoline-powered engines, BRICs and other emerging markets, etc.). The switch to direct sales was instrumental in bringing about improved profitability and new product development (% of sales from new products improved from 4.5% in fiscal year 2001 to 7.8% in 2004).

In 2004, Horiba acquired the Driving Testing System Division of a German company Schenck. The DTS Division of Schenck, which had annual sales of \$100 million, complemented the Engine Division of Horiba. Schenck was weak in emission analyzers but had strengths in areas that Horiba was weak (e.g., driveline testing, wind tunnel, brake testing, and dynamometers).

Distinctiveness: Leader in emission analyzing system with 80% world market share.

Innovation: Product development activity that allows both global efficiencies and local adaptation.

Developed three technology centers in the U.S., Japan, and Germany, each with different technological specialty, allowing the company to establish virtual headquarters.

Trade-off:

Don't sell stand-alone equipments.

Don't concentrate engineering capabilities geographically.

Don't offer standard products across the border.

Don't sell general-purpose environmental analyzer to customers whose willingness-to-pay is low.

END OF DOCUMENT