2003 Porter Prize Winners

<table>
<thead>
<tr>
<th>Single Business Category Winners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Suruga Bank Ltd. (Regional bank)</td>
</tr>
<tr>
<td>Seven-Eleven Japan Co., Ltd. (Convenience store)</td>
</tr>
<tr>
<td>Trend Micro Incorporated (Anti-virus software services)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Division of Multiple-Business Company Category Winner</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bicycle Components Division, Shimano, Inc. (Development, manufacturing and sales of bicycle parts and components)</td>
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</tbody>
</table>

Selection Criteria
The essence of strategy is to do things differently from others. Based on this premise, the Porter Prize recognizes those companies and business units that have chosen to compete in a distinctive way in a particular industry by delivering a unique value proposition, based on innovations in products, processes, and ways of management.

First-stage Selection Criteria
1. Superior sustainable profitability within the industry
2. Unique/different value proposition
3. Strategic continuity over time
4. Innovations that enable the strategy

Second-stage Selection Criteria
5. Utilization of capital analysis
6. Distinctive value chain
7. Trade-offs
8. Fit across activities

(Note: In the analysis of capital utilization, the key focus will be ROIC (Return on Invested Capital) and ROS (Return on Sales). The following report of the winners includes a comparison of these figures with the industry averages. A positive figure exceeding the industry average indicates the capital utilization of a company or business is better than the industry average. The five-year average for a particular company has been calculated by totaling the numerators for each year, and dividing this figure by the aggregate total of denominators for the same five years. Please note that the derived five-year average is not equal to taking a simple average of the ratios for the five years. The data that is used in calculating the industry average was obtained by carefully selecting companies that allow for a true comparison among those classified as being in the same industry. (The Porter Prize Organizing Committee is grateful to KPMG for its support in providing data and carrying out the analysis for capital utilization during the second-stage selection process.)
Selection Rationale (Recipients are addressed in no particular order): Suruga Bank Ltd.

Continuous development of new products and unique services based on highly original approaches, which enabled for Suruga Bank to provide services that had not been available to its customers.

(Note: Suruga Bank is a regional bank headquartered in Numazu City in Shizuoka Prefecture.)

Unique Value Proposition

As a cornerstone of its specialization in the retail market, Suruga Bank provides unique products based on a highly original perspective, with the goal of responding to individual customer needs on a one-to-one basis, as expressed by its vision to be the best “concierge.” For example, Suruga dispensed with the requirement of a minimum of two years’ employment at the time of mortgage loan application submission, marking a departure from a common industry practice. This change enabled Suruga to extend loans to competent system engineers who tended to move from one place of employment to another. Furthermore, they were the first Japanese financial institution to develop and market a mortgage loan product that could be extended to individuals who had not been able to acquire a mortgage loan for having been rejected for group-guaranteed life insurance. Suruga has 26 types of mortgage loan products, offered in combination with four types of mortgage loan insurance. This extensive product lineup, which can be combined with mortgage loan insurance makes it possible for the bank to meet specific customer needs. (cf. Most Japanese banks offer only one to five mortgage loan products).

As seen from these examples, many of Suruga Bank’s products cater to customers who were unable to qualify for the ordinary mortgage loans offered by banks. Suruga positions its unique products as “dream enablers,” without which customers would likely not realize their dream of owning a home (or condominium). (More than 90% of Suruga’s mortgage loan customers purchased a type of mortgage loan product that cannot be found at other financial institutions.)

Suruga Bank has a very quick loan screening process, averaging a turn-around time of under 48 hours, with a same-day response quite common. The norm in the industry for mortgage loan screening is 3 to 5 days. Not only does Suruga Bank respond quickly to loan applications and offer an extensive product lineup, it also provides individuals an efficient way to search for real estate property search, as well as functioning as an effective sales channel for real estate providers (agents, housing developers, and builders among others), who also serve as mortgage loan sales partners for Suruga Bank.
It also diminishes the likelihood of cancellations due to mortgage loan unavailability once a decision to purchase has been made, thereby reducing inefficiencies.

Suruga Bank tries to be the best “concierge” to non-mortgage loan customers by addressing the specific needs each individual on a “one-to-one” basis. Every member of the customer service staff can easily access individual customer information, and retrieve from the database a customer’s entire transaction history and his or her approved loan limit. Such information enables the bank to propose service options that meet specific needs their customers hadn’t even known existed.

**Unique Value Chain**

Product Development: The product development criteria of Suruga Bank are threefold: 1) A new product must allow for customization to meet the individual customer’s needs; 2) It must provide access to a niche market; and 3) It must not currently be offered by other banks. Suruga’s ability to develop unique products is supported by its vast accumulation of loan screening data regarding an individual’s repayment capabilities, its extensive assessment know-how, an automatic lending examination system, and a Customer Relationship Management (CRM) system. In addition, Suruga constantly works to develop channels for collecting detailed information concerning the financial status of individual customers and their financial needs. Suruga Bank also frequently conducts market surveys by mailing out questionnaires to identify latent customer needs. At the same time, the bank encourages its employees to maintain close contact with customers through daily activities, so as to gain a clear understanding of customers’ needs. Two examples of the new products cited above were developed in response to reports by employees concerning unmet customer needs, based on responses during interviews with people in the real estate channel.

Suruga Bank took this thinking one step further and undertook a clear delineation of responsibility. Front-line employees were made responsible for proposing ideas for new products and services. Meanwhile, the corporate planning staff was assigned the task of taking the proposals and turning them into actual, marketable products. All employees have access to the bank’s intranet system, named “21st Century Explorers.” The proposed new product ideas posted on this site are thus made accessible to the entire staff. When a proposal is input into the system, the corporate planning department and the other departments directly involved are required to respond and provide a feedback within 48 hours. The site “21st Century Explorers” is one of the most active sites on the bank’s intranet system, and since its inception, the ideas posted on this site have led to the development of more than ten new products, and also more than ten innovations for existing products.
Marketing and Sales: Suruga Bank’s sales activities for its existing customers are based on proposals developed through the use of a loan pre-approval system and a CRM system. Suruga is able to provide products and services quickly, and at a low cost as a result of the installation of these two systems.

Product/Service Provision Channels: The bank’s “Housing Loan Centers” are branch offices that specialize in the provision of mortgage loans. These branches are opened in strategic locations where mortgage loan demand is high, such as Tachikawa, Shinjuku, Omiya and Kashiwa (all within commuting distance to Tokyo) and Kohoku New Town, (near Yokohama). These locations are far outside of Suruga’s original base of operations, namely Shizuoka and Kanagawa prefectures. For the convenience of customers who live in areas in which Suruga does not have branches, the bank had created the most extensive ATM network in the industry by forming alliances with convenience store chains and the postal service network. Suruga also made on-line banking services a priority by opening and operating eight on-line branches, with each one specialized in a different niche segment.

Planning: Seeking to be the best “concierge” and a pioneer in the industry, Suruga Bank hosts an annual event called “The Junior Board,” during which front-line employees develop various new plans and present them directly to the CEO. The management also introduced an important change in the corporate culture. Whereas previously emphasis had been placed on minimal tolerance for failures, the management now encourages employees to act quickly on ideas with a 65% or higher probability of success. Consequently, the time between an idea’s proposal and its implementation has been reduced considerably.

Infrastructure: The back office operations of branch offices (which include form processing for bill issuing and foreign exchange, and the handling of telephone inquiries) have been centralized at the headquarters to improve the efficiency of branch operations. The remaining administrative tasks at branch offices are handled by the staff, and each staff member is expanding the number of tasks for which they are responsible. The aim is to perform five different duties as a professional.

Suruga Bank has developed a database of rules and procedures, enabling branch employees to access it and make quick on-line inquiries while seated at their desks dealing with a customer. This system, which facilitates inquiries and the retrieval not only of rules and regulations, but also work process flow charts, makes it much easier for inexperienced junior staff and part-time staff to follow the correct procedures.
Fit Across Activities

One of the key activities of Suruga Bank is loan screening. The bank has accumulated a wealth of personal financial data over the years in the course of extending small-amount loans to individuals, as well as extensive loan screening know-how, which has enabled the development of an automatic lending examination system. This system, applied to both small loans and mortgage loans, is what has allowed Suruga Bank to dramatically speed up the loan screening process.

The distinctive feature of Suruga’s screening process is the emphasis placed on an individual’s loan repayment capabilities rather than on the collateral value of the mortgage. By measuring and assessing an individual’s ability to repay the loan, Suruga has been able to develop new loan products from an innovative perspective.

Suruga also analyzes the financial requirements of existing customers, and by linking the CRM system and the preliminary loan screening process, the bank’s loan officers can talk to customers with a clear idea of their credit lines, and can propose numerous options.

Other key activities at Suruga Bank include the sharing of the bank’s vision of being the best “concierge,” and motivating employees by encouraging them to propose new services and other improvements. These activities inspire and empower employees, who in turn develop new products and increase loan sales by making proposals to customers, while making best use of the loan screening data, the CRM information, and the market information gained through real-estate channels.

(Please refer to the attached “Activity System Map” for a more detailed account of the relationship between these activities.)

Innovations that Enable the Strategy

- The establishment of Housing Loan Centers (HLC) with specific key functions
- The opening of HLCs in the Tokyo metropolitan area, on-line banking functionality, and the creation of the industry’s largest ATM network, all of which eliminated geographic and time constraints on sales activities
- The introduction of an automatic loan screening system, which enables extremely quick assessments, unique product development and sales through proposal-making, as well as reduces the likelihood of cancellations after purchase decisions have been made
- The installation of the Intranet system “21st Century Explorers”, which enables the collection of new product ideas and proposals from front-line staff, and makes this data available to all staff members
- The establishment of the “Junior Board,” whereby the front-line staff is given the
opportunity to develop medium- to longer-term proposals and present them directly to the CEO

Continuity of Strategy
In 1988, when full banking services were a common practice of all banks, Suruga Bank made the strategic decision to specialize in retail banking services for individual customers, and has maintained this strategy ever since. At Suruga’s loans to individuals comprise 63.8% of the total outstanding loan balance, which is the highest percentage of loans to individuals in the industry and far ahead of the second bank in this regard. (Note: Suruga Bank continues to conduct loan transactions with small-to-medium-size businesses through direct channels at its headquarters and one centralized corporate banking branch.)

Trade-offs
- By concentrating on retail banking for individuals, Suruga Bank chose to discontinue its transactions and services for big corporations. As a result, the bank’s need for overseas branches was significantly diminished, and branches that had relied heavily on corporate banking and business processes for derivatives and M&A were dramatically reduced. After some transition years, the bank closed down all of these operations. Suruga also stopped making corporate sales calls, and no longer made visits to an individual customer’s workplace.
- The creation of an extensive ATM network and on-line banking systems greatly reduced the importance of a network of domestic branches. Seeing this result, Suruga closed all branches other than those in its core market in Aichi and Yamanashi prefectures.
- With personnel and funds freed up by these developments, Suruga Bank opened HLCs in the Tokyo metropolitan area, providing work to employees. By specializing in individual customers, the bank was able to concentrate its resources on building excellent information systems.
- Suruga Bank does not actively market the type of standard mortgage loan packages that are offered by other banks, because it aims to provide unique products that are available only at Suruga Bank.

Profitability
In recent years, more and more banks, including mega-banks, have started to emphasize retail banking, which has brought about a price competition in the mortgage loan market. However, because of its unique products, Suruga Bank has been able to avoid a price competition, and as a result, it has secured a loan margin spread that is double the industry average. The bank’s operating profit margin is much higher than the industry average, and its return on invested capital has also consistently exceeded the industry
average.

**Return on Invested Capital (ROIC): Suruga Bank Ltd.**

(Unit: Percentage points)

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<tr>
<th>5-Yr. Avg. Margin Above Industry</th>
<th>Annual Margin Above Industry</th>
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<tr>
<td>1998 0.8%</td>
<td>0.7% 0.6% 0.4% 0.2% 0.8%</td>
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**Return on Sales (ROS)**

(Unit: Percentage points)

<table>
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<tr>
<th>5-Yr. Avg. Margin Above Industry</th>
<th>Annual Margin Above Industry</th>
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</thead>
<tbody>
<tr>
<td>1998 25.9%</td>
<td>14.0% 9.6% 5.2% 5.1% 21.7%</td>
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(Note: Return on Sales = Operating Profit/Operating Revenue; compared to all the banks listed on the Tokyo Stock Exchange)
Activity System Map --- Suruga Bank Ltd.

- **Highly motivated employees**
- **Employee suggestions accepted via "21st Century Explorers"**
- **Sales activities through proposals that stimulate latent customer demand**
- **CRM system dedicated to individuals**
- **Common vision to be the best "concierge"**
- **Products customized to meet each individual customer’s needs**
- **Database of loan screening data created to improve assessment of creditworthiness**
- **Sales of high value-added products targeted to niche markets**
- **Discontinuation of handling of accounts with big corporations**
- **Loan approval determined not by collateral value but by ability to repay**
- **Discontinuation of handling of standard mortgage loan products**
- **No overseas branches and no antenna branches in big cities**
- **Small loans marketed via nationwide online direct banking**
- **Introduction of an automated loan screening system**
- **Extremely quick loan screening process**
- **Housing Loan Centers in Tokyo metropolitan area specializing in mortgage loan services**
- **Utilization of real estate channel**
- **Convenient Internet banking services and an extensive ATM network for customers outside Shizuoka prefecture**
- **No overseas branches and no antenna branches in big cities**
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Porter Prize Organizing Committee  
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E-mail: info@porterprize.org  
http://www.porterprize.org
Selection Rationale (Recipients are addressed in no particular order):
Seven-Eleven Japan Co., Ltd.

Tenaciously working to create a mechanism that allows for the efficient provision of consistently high-quality items – every little thing required between the time one wakes up in the morning and the time one goes to sleep at night, taking into account frequent variations in consumer preferences that are affected by geography, the season and the time of day.

Seven-Eleven Japan was established in 1973. Its average daily sales per store was the highest among the leading convenience store chains, with 10 million customers visiting Seven-Eleven stores in a single day, and each customer visiting one of its stores every two days on average.

Provision of Unique Value
Seven-Eleven Japan (hereafter Seven-Eleven) provides those “little necessities” in everyday life to the local customers of each store, one of 10,000 located all over Japan and open 24 hours a day, 365 days a year. “The convenience store is my refrigerator” is an often-heard expression that describes the nature of a Seven-Eleven store, where you can immediately get that little item you want at that moment. It’s available at a store just around the corner. Quite simply, Seven-Eleven stores offer convenience. Seven-Eleven’s average daily sales per store attests to the uniqueness of its merchandise and the degree to which it matches customers’ preferences. Average daily sales per store for the Seven-Eleven chain is ¥650,000, which is ¥150,000 yen higher than the average of Japan’s top five convenience store chains excluding Seven-Eleven.

Unique Value Chain
Ordering/Merchandise Selection/Inventory Management: The selection of merchandise to be placed in the store with a floor space measuring approximately 110 square meters is the result of efforts to precisely meet customer needs. In addition, merchandise selection and display locations are frequently varied according to local events, changes in season and weather, and customer preferences. As a result, 70% of the merchandise is replaced during the course of one year.

What makes it possible is firstly the proactive ordering undertaken by each store. To facilitate ordering, all employees, including part-timers (there are 20 part-timers per store on average), are responsible for placing orders, changing displays and stocking the shelves. Secondly, Seven-Eleven achieves extremely high accuracy in distinguishing between strong selling items and poor performers. Seven-Eleven has created a system to grasp in real time the inventory situation for each merchandise item in every store. It
can identify those items that do not move at all, and can tell whether an item has sold out in two hours or eight hours, for example.

The third reason is ordering based on hypothesis formulation and verification. Store staff in charge of ordering (part-time staff included) are encouraged to talk with customers and find out about factors relating to the neighborhood in which a store is located that might affect the sales volume of a particular item in the immediate future. Details that might have an impact on products sales include the duration of construction work in town or an athletic meet among local schools. Seven-Eleven also provides easy-to-understand on-line graphic presentations of weather forecasts, publicizes major events in the region, and offers POS information and new merchandise information. Integrating all this information, the staff member in charge of ordering formulates hypotheses about what kind of customers buy which kinds of items under which circumstances. Orders are placed based on the hypotheses formulated. The staff member then reviews actual sales after the event, and revises his or her hypotheses for the next ordering opportunity. This cycle is constantly repeated in each store. The second factor in management via inventory information is a post-facto response, allowing the company to respond to changes that have already occurred. The third factor in ordering by hypothesis is forecasting changes that are likely to occur in the future.

Seven-Eleven thoroughly implements analysis of inventories and hypothesis formulation to constantly ensure that those little necessities are always available to every customer. As a result, its chain stores have continued to realize approximately 5% growth in aggregate sales amid the current deflationary economy. At the same time, Seven-Eleven stores have achieved a very low inventory ratio. Seven-Eleven’s inventory turnover in FY2002, at 41.9 times, was significantly higher than that of any other retail business formats (cf. 12.2 times for a Japanese supermarket chain Ito-Yokado, and 7.9 times for a U.S. leading discount store chain).

Merchandise Proposals: Ordering by franchisees is done from a list of recommended merchandise sent from Seven-Eleven headquarters, and new merchandise items are added to this list every week. The headquarters adds 80 new items a week, and a total of 4,000 new items are recommended each year. Furthermore, about half of these new items are original merchandise developed as part of merchandising team efforts described below.

Merchandise Development: In order to offer merchandise that responds to latent customer demand, Seven-Eleven works jointly with manufacturers to develop new products to be put on the store shelf. For example, in the case of development of a plastic container for an instant Chinese noodle (“Rahmen”) served at a well-known and
immensely popular noodle shop, a merchandising team was formed. This project team comprised representatives from noodle shops, a freeze-dried noodle manufacturer, a soup manufacturer, a manufacturer of the ingredients in the noodle dish, and a container manufacturer.

The activities of such a team are not limited to product development, but also cover detailed planning of sales promotion and the adjustment of commercial and physical distribution flows. One such team discovered that the taste of cooked rice dishes deteriorates faster at temperatures both above and below 20 degrees Centigrade. The team went on to develop special vehicles for transporting cooked rice dishes that allow the food to be kept warm at the specified temperature. This team merchandising approach has been utilized for a wide range of products, including boxed lunches, rice balls, sandwiches, packaged side dishes, snacks, soft drinks, beer, and toys. As a result, original products only available through Seven-Eleven currently account for 50% of the company’s total sales.

Merchandise development activities at Seven-Eleven are not limited only to physical products but also include services, such as the collection of public utility charges, made possible through the leveraging of the store’s three types of networks (information, transaction and physical distribution networks) as a platform.

Store Network Expansion: The opening of a Seven-Eleven store is based on a franchising system, and done through the intensive recruitment of franchisees within a limited geographic area (utilizing an area-dominant strategy). The total number of Seven-Eleven stores now exceeds 10,000 in Japan, which is the largest of the industry. However, the Seven-Eleven store network covers 32 out of the 47 prefectures (i.e., a coverage rate of 68%). This means there are twice as many Seven-Eleven stores as any other convenience store chain in those prefectures that the company has chosen to enter.

Physical Distribution: Seven-Eleven has built a dedicated physical distribution system that can carry and deliver the products of a number of manufacturers, and it includes specialized trucks equipped with temperature controls, so that frozen food can be transported at minus 20 degrees Centigrade, chilled goods and beverages at 5 degrees, and cooked rice dishes at 20 degrees. Deliveries are run three times a day for chilled and cooked rice items, so that deliveries arrive just before the peak of sales for such items. However, the total number of deliveries per day is kept below 10 times per store. Physical distribution management at Seven-Eleven has resulted in better temperature control, the shortest possible lead-times, and improved inventory efficiency, enabling the freshness of food products in the store to be ensured.
Store Operation Support: The FC (Franchisee) Meeting is held at Seven-Eleven headquarters in Tokyo every week, on Tuesdays. These meetings are attended by 2,000 people, including Operation Field Counselors (OFC or store management advisors) from all over Japan, Recruiting Field Counselors (RFC or store network development staff), and management at the headquarters, who gather together and listen to directives and policies from the top management, and share information with participants regarding products, markets and store management know-how. Each OFC visits assigned franchisees at a rate of more than two visits a week per store, and communicates company policy and shares information and know-how with franchisee personnel, face to face. Information provided in face-to-face meetings is combined with communications via IT systems. Store managers utilize this information to improve store operations and expand sales. OFCs relocate to the geographic area under their supervision, and they travel every week to Tokyo to participate in the FC Meeting. OFCs travel to Tokyo from all parts of Japan for these meetings. Consequently, the total costs incurred in the attendance of these weekly meetings, which includes transportation and lodging, add up to ¥3 billion a year.

Partner Support: Seven-Eleven serves as the headquarters for franchisees, and works together with franchisee stores, physical distribution operators, information systems management and operating firms, and merchandise manufacturers to achieve smooth and efficient operations. Its role can be summarized as the accumulation and improvement of know-how and knowledge sharing. As an example, in the area of physical distribution, Seven-Eleven plays a key role in the development of dedicated delivery vehicles, providing logistics center management methods, and sharing physical distribution know-how with 294 distribution centers spread throughout Japan. Regarding the information system developed for interfacing with suppliers and business partners, Seven-Eleven not only offers an order and payment processing function for its stores, but also shares inventory and POS information at the store level so that such information can be directly fed and linked with each partner’s inventory control, production management and purchasing systems.

**Fit Across Activities**

By pursuing an area-dominant strategy, Seven-Eleven gains such benefits as higher brand/store recognition in the area, more frequent customer visits, efficiency in physical distribution, enhanced efficiency of services to support franchisee stores, and more effective advertisement and sales promotion activities.

As a result of efficient physical distribution, namely due to an area-dominant strategy and the communal use of physical distribution channels by suppliers, Seven-Eleven can schedule deliveries at precisely controlled temperatures. Strict temperature control
means that Seven-Eleven’s food items do not need to use preservatives or synthetic coloring additives, which enhances the attractiveness of the company’s merchandise. Furthermore, the creation of a physical distribution network that allows for strict temperature control has enabled the development of original merchandise, such as beer, to be delivered directly from the factory and chilled foods such as freshly boiled noodles that can be warmed and served in a few minutes at home. All of these are unique to Seven-Eleven and cannot be copied by other competitors. (Please refer to the attached “Activity System Map” for a more detailed account of the relationship between these activities.)

**Innovations that Enable the Strategy**

- With a hypothesis-formulation approach to ordering, stores can anticipate the constantly changing customer needs, and keep the required merchandise always on the shelf prior to the occurrence of anticipated events. Every member of the ordering staff in each store is trained and shares this know-how.
- Since the introduction of the POS system in Seven-Eleven in 1982, the company has used the system not only to reduce its manpower, improve information accuracy, and prevent theft, but also used it to access sales information per item for marketing purposes. The company has developed a real-time inventory management system that can account for each piece of stock keeping unit (SKU) in cooperation with its partners. Most of these information systems are the first ones of their kind in Japan and unique to Seven-Eleven.
- Shared physical distribution, optimum temperature control in distribution, deliveries three times a day, and an area-dominant strategy contribute to Seven-Eleven’s efficient logistics system.

**Continuity of the Strategy**

The key elements of Seven-Eleven’s strategy have been in place since the company’s establishment in 1973, including its policy of offering every little thing required between the time one wakes up in the morning and the time one goes to sleep at night, a franchising approach, an area-dominant store network development strategy, a policy of refusing to handle projects that fall outside the scope of the franchiser headquarters role but agreeing to work together with partners in different industries, and inventory management by each SKU item.

**Trade-offs**

- Seven-Eleven Japan refused to appeal to customers with low prices. Unlike many private-brand products sold through other retail chains, even the original merchandise developed through the team merchandising process is not sold at a price that undercuts those of comparable national brands. In principle, neither does...
it practice discount sales.

- In order for each store to offer merchandise that meet customer needs with limited shelf space and the stockyard inside the store, Seven-Eleven emphasizes the selective screening of merchandise that sells, rather than offering customers a broad selection. For example, it allocates more shelf space to the best selling canned coffee products, even if it means reducing the number of different brands to be sold. The company does not add variety just to fill up shelf space.

- Seven-Eleven does not expand its store chain network through directly operated stores.

- The company does not sacrifice efficiency in physical distribution by expanding the geographic scope of its operations.

- It does not design and open a store with a big floor space beyond what can be managed by a store manager and a few part-time staff.

- Seven-Eleven only performs tasks consistent with its role as core headquarters for convenience store franchisers. Its activities are mostly limited to franchisee support, merchandise development, information sharing and IT infrastructure development and maintenance.

**Profitability**

Seven-Eleven Japan consistently surpasses by a wide margin the average for the convenience store and supermarket chain industry, in terms of both Return on Invested Capital and Return on Sales.

### Return on Invested Capital (ROIC): Seven-Eleven Japan Co., Ltd.

(Unit: Percentage points)

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<td>16.1%</td>
<td>14.3%</td>
<td>15.3%</td>
<td>16.2%</td>
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<td>14.6%</td>
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### Return on Sales (ROS)

(Unit: Percentage points)

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<tr>
<td>38.3%</td>
<td>36.1%</td>
<td>39.4%</td>
<td>39.2%</td>
<td>39.0%</td>
<td>36.0%</td>
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Activity System Map --- Seven-Eleven Japan Co., Ltd.

- **Sharing of retail sales information with partners**
- **Joint development of original merchandise with partners**
- **Disposal of perishables that are no longer fresh**
- **Detailed retail sales data obtained at time of transaction**
- **Timely provision of merchandise that always fits the requirements of everyday life requirements**
- **No deterioration in merchandise freshness**
- **Ordering process involves forecasting future needs using hypothesis & verification cycle**
- **Extensive inventory management (by merchandise item)**
- **Frequent deliveries to each store (three times daily)**
- **Joint distribution, integrated distribution by merchandise suppliers**
- **Order placement duties assigned even to part-timers**
- **An area-dominant strategy that focuses on the concentration of stores in a geographic area**
- **Sales support by twice a week store visits by OFCs**
- **Weekly meeting for FCs and managers, enabling 2,000 staff members to share**
- **Potential and changing needs identified through conversations with customers**

*OFC stands for Operation Field Counselor, or store management counselor, and it is an original term for 7-11. (In the retail industry, this position is generally known as store supervisor.)*
Selection Rationale (Recipients are addressed in no particular order):
Trend Micro Incorporated

Specialization in anti-virus software services in the broader area of network security, and its dedication to accumulating virus information and developing solutions faster and more effectively than any of its competitors, through the efforts of staff in development centers around the world, working 24 hours a day, 365 days a year.

Trend Micro was established in 1988, and currently is the third largest anti-virus software vendor in the world. (Trend Micro holds a 14.3% share of the global market, while the industry leader has a 36.6% share, according to IDC Market Analysis.)

Unique Value Proposition
Computer viruses are unpredictable – they can breakout anywhere in the world without notice, and they spread very rapidly. Trend Micro provides anti-virus solutions, and aims to deliver them to the market faster than anyone else. It offers corporations and individual customers virus prevention and quick recovery services in the case of computer or network contamination.

The application of anti-virus measures at the gateway enables customers to avoid declines in business efficiency. Should contamination occur, a recovery can be quickly achieved, allowing for efficiency to be restored.

Unique Value Chain
Technology development: Trend Micro maintains teams of engineers in various locations in the world, including Japan, the U.S., Taiwan, Germany and China, and these teams all work closely together to develop new products through the real-time sharing of information over their network.

After-sales services: Over 250 research staff – carefully chosen for their skills – are stationed in the Philippines, Taiwan, California, Munich, Paris and Tokyo. They collect, research and analyze data on computer viruses 24 hours a day, 365 days a year.

Operations: Trend Micro provides products and extends services that range from the prevention of virus contamination, to isolation and recovery services. Even after the expiration of the guaranteed support period (one year from the date of purchase), a customer need only purchase the updated contents and support services rather than having to pay for the entire package again.
Marketing and sales: Trend Micro’s sales approach varies for the Japanese and overseas markets, although the company always target major businesses. When entering overseas markets, Trend Micro targets large corporations that are on the “Fortune 1000” list. Such companies generally have experienced IT system management staff in-house, allowing Trend Micro to adopt a direct sales approach. In the case of Japanese companies, however, there is no guarantee of finding a capable IT manager working in-house. Instead, Trend Micro works with system integrators who are familiar with the networks of major companies. The company uses these system integrators as its sales channel, and provides system integrators with extensive support.

Fit Across Activities
Trend Micro’s activities share the single objective of developing and providing anti-virus measures faster and more effectively than anyone else. Although the staffs are dispersed across the globe, it manages to capitalize on the strengths of each location while striking a balance between local autonomy and central coordination for each function. Information gathering activities are conducted throughout the company’s network and basically left up to each country. Solution development, however, is conducted in regional centers utilizing virus information fed in from each country. The actual provision of countermeasures is left up to the local operations in each country, as they would have the best understanding of the customers in each market. The method for cultivating customers is also left to each country.

Anti-virus software development is very complex due to the considerable number of OS platforms which must be accommodated, such as MS Windows, Unix and Linux. Trend Micro, however, can develop responses quickly because its staff focuses solely on the provision of anti-virus software without having to worry about integration with other network security software.

Trend Micro targets the most demanding customers in each country, and focuses on providing them with high-performance products and services. This market segment puts a high priority on performance. Once a product or service is found to be effective, its reputation is spread easily through target marketing and via word-of-mouth. Thus, there is minimal need for advertising. Consequently, Trend Micro, as a Japanese company, does not need to spend large amounts on advertising to improve its brand image.

Although Trend Micro’s development activities and overseas sales activities target the major companies in Japan, they also actively develop and sell to small and medium-sized companies, local and national governments and agencies, as well as individual consumers. Trend Micro has successfully penetrated these markets, and has established itself as the market leader in these segments.
Please note, however, that the company has not sacrificed an effective fit across its activities for the sake of penetration in different segments. Because of product characteristics associated with software, increases in product variety do not require additional investments in manufacturing facilities or result in higher inventory costs. Changes in software content do not require much investment either. There is little need for advertising and other sales promotion activities as the company’s brand recognition continues to grow. There is no need to build a large sales force because unlike other companies that sell directly to end users, Trend Micro conducts sales to small and medium-sized companies through system integrators.

(Please refer to the attached “Activity System Map” for a more detailed account of the relationship among these activities.)

**Innovations that Enable the Strategy**

- Trend Micro succeeded in developing anti-virus software that functions on Internet entries and exits (gateway servers), and marketed this software earlier than any other company (with patents registered in 1996). Even today, its gateway products hold a 40% share of the global market, which is double the share of the closest competitor in distant second place.

- Trend Micro’s organizational management skills as a global corporation working across borders enables a rapid response to viruses that spring up in any part of the world and rapidly multiply.

**Continuity of Strategy**

Trend Micro has been focusing on anti-virus software since its establishment in 1988.

**Trade-offs**

- Trend Micro does not develop products other than anti-virus measures in the broader area of network security. (This includes access limitation to network/fire walls, the monitoring of unauthorized access/IDS, etc.) (Cf. Other competitors are active in these areas that Trend Micro declined to enter. Their strategy is to package a number of solutions for several security areas into a single product, thereby enabling users to integrate operations and management of network security into one solution.) Trend Micro believes that it would not be able to fight the numerous viruses that spring up and rapidly mutate in a short period of time if resources had to be spread over many security areas and developed as an integrated package.

- Trend Micro tries to minimize inconveniences to users, who are required to seek different products for each area, by cultivating alliances with other category leaders.
and making products compatible with those specialized in different areas. Trend Micro markets its products in a package with complimentary security products at a special price, as well as offering bulk-purchase discounts.

- As Trend Micro emphasizes differentiation by function, its products sometimes fall short in terms of ease of operation and maintenance for inexperienced users.
- Trend Micro does not actively invest in marketing or spend considerable amounts on consumer advertising to improve its brand recognition.

**Profitability**

Trend Micro’s return on sales consistently surpasses the software service industry’s average by a wide margin. Its return on invested capital is also higher than the industry average.

Trend Micro greatly increased its invested capital by listing its stock on the OTC market in Japan in 1998, listing on NASDAQ in the US in 1999, and also on the first section of the Tokyo Stock Exchange in 2000. In such a situation, return on invested capital usually declines, but Trend Micro consistently improved the return, and the gap with the industry average is widening.

**Return on Invested Capital (ROIC): Trend Micro Incorporated**

(Unit: Percentage points)

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<thead>
<tr>
<th>5-Yr. Avg. Margin Above Industry</th>
<th>Annual Margin Above Industry</th>
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<tr>
<td>13.9%</td>
<td>2.0% 3.7% 7.5% 7.5% 17.2%</td>
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**Return on Sales (ROS)**

(Unit: Percentage points)

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<tr>
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<td>20.0% 27.1% 30.1% 26.3% 28.3%</td>
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</table>
Activity System Map---Trend Micro Incorporated

Refusal to enter other network security areas

Formation of alliances with leading vendors specializing in other security areas, such as firewalls

Specialization in anti-virus software and concentration of management resources

Refusal to enter other network security areas

Incorporation of feedback from customers with varied backgrounds in the product development process

High-quality support systems

Growth in customer base in geographic areas where no sales channels for the brand

Improved customer satisfaction

Creation of unique security solutions

Short turnaround and low-cost research and development based on narrowly defined network security area

Extreme quick response to threats from new types of viruses

Demonstration of product performance, using actual installation examples

Registration of patents

Prestigious clients that include global corporations

Relatively low advertising budget

Sales and marketing approach chosen to fit characteristics of each region

Extremely quick response to changes in business environment, such as emergence of new network format, e.g., wireless networks

Stock option program made available to all employees, including staff at overseas operations

Recruitment locally of talented individuals in each region

Constant provision of more effective, higher performance products

Strong image: "Trend Micro is advanced"

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Strong image: "Trend Micro is advanced"
Selection Rationale (Recipients are addressed in no particular order):
Bicycle Components Division, Shimano Inc.

Achievement in systematizing bicycle parts, and constantly upgrading and seeking higher performance products through the establishment of close ties with leading bike users and bike shops. Despite being a components manufacturer, Shimano also created a new mountain bike market. The Shimano brand has earned a high level of confidence among users that far exceeds that of any of its competitors.

Established in 1921, Shimano has earned itself the leading position in the global bicycle component industry. It is believed that Shimano holds 60-70% of the global market for bicycle components for competition use.

Unique Value Proposition
Shimano focuses on key functions such as gear changers, brakes, and power driving mechanisms that determine a bicycle’s performance, including its handling and safety. Moreover, by designing each component as an integral part of a system, Shimano is able to deliver a level of performance, handling and comfort to end-users that cannot be attained by merely combining and assembling discrete parts. For example, Shimano integrated a brake lever and a gearshift lever that had been separate and independent parts until the company developed a new system that greatly enhanced the ease of handling. Because of easier handling, professional road racers were relieved of the extra stress in the gear-shifting process, and could instead concentrate on negotiating the road and pay attention to the other competing racers. When the mountain bike market was just taking off, Shimano also started offering totally new features of durability and protection from mud and dirt, in addition to achieving the innovation of allowing users to shift gears while holding onto the handlebars. This innovation simplified maintenance, and more people became able to enjoy dirt road running without having to worry about special care.

Shimano’s system performance was honed in the road racing and mountain bike markets, and its system application was extended to the comfort bike category, which included bikes for leisure and city use. This represented a significantly larger bike market for the general public, who could now enjoy high functionality with ease.

Unique Value Chain
Technology development: Shimano’s engineers who are responsible for developing individual parts and components place an emphasis on the system’s performance as a whole. They develop and test products with the primary objective of realizing the system concept. The priority is on realizing the system’s smooth performance, rather
than on maximizing the performance of each single part.

Shimano focuses its product development on the high-end segment of road racing and mountain bikes, and every year it introduces new products that achieve improvements in functionality, ease of handling and comfort. The company has created an organization for outside elite riders of mountain bikes, and periodically gives them prototypes of products to test drive on the road.

Shimano receives requests and complaints from end-users via two different routes: directly and through bike shops. As a direct-route activity, Shimano meets bicycle users by sponsoring bike racing teams, holding races and events with “Shimano” sponsorship, and by sending its staff to work as mechanics at races. The Shimano Suzuka Road Race has a 20-year history, while Shimano Bikers Festival is 13 years old. These events are managed and operated by Shimano staff members, who fulfill a variety of roles ranging from mechanic and race judge, to parking attendant. Such occasions are an opportunity for many of the Shimano staff to enjoy direct contact with bike lovers. By speaking to end-users directly, the staff can gain an understanding their needs. As for the bike shop route, Shimano arranges “dealer caravans,” during which staff members make visits to individual bike shops. The company also conducts new product presentations to which bike shop personnel are invited. These events are attended not only by marketing and sales staff, but also by representatives from the development and engineering departments as well as quality assurance staff, who talk with bike shop employees to find out their requests and complaints.

Through its collaboration with other parts manufacturers and bike manufacturers, Shimano looks for a future direction for new-style bikes and develops “concept bike” proposals. The company aims to come up with proposals that would not have been possible by merely relying on existing parts technology alone. It is also willing to make drastic changes the bicycle’s design.

Marketing and sales: Shimano focuses its promotional activities on the high-end market. It has established brand recognition and a reputation for high performance in Europe and US, which are the primary markets for high-performance bicycles, through the sponsorship of professional road racing events and professional racing teams. In Japan, the company sponsors such events as the “Shimano Suzuka Road Race” and the “Shimano Bikers Festival.” Sponsorship of such events helps to further strengthen the company’s brand recognition among bike lovers.

These events help expand the market, and sometimes even create new markets. For example, a new pastime called mountain bike riding emerged in the late 1980s. This
activity was started by a small group of bike users. Shimano took the initiative by supplying parts tailored to fit this riding style, and then persuaded assembled bicycle manufacturers to market new products. The company also held events to promote mountain bike riding to support and expand this emerging market segment.

Shimano extends strong support to bike shops, which are its primary sales channel for reaching high-end customers. Shimano established a sales subsidiary in the U.S. as early as 1965, and its own staff provided direct support for local bike shops in that market. In addition to organizing dealer caravans and new product presentations to display and demonstrate Shimano products and hosting training events for repair and maintenance, the company also dispatched selected staff from Japan to bike shops in the European and U.S. markets for three-month periods, whereby the staff learned first-hand about the work done in a bike shop and the characteristics of the local bike community in each market. No other bike parts manufacturer provides such extensive support services to bike shops. This support is what has earned the company a high degree of trust from bike shops.

After sales services: Through the hosting of dealer caravans, Shimano teaches bike shop personnel about product features and repair techniques. Since Shimano introduces new products every year, ensuring a continuous supply of repair parts for former models can become an issue. Thus, in addition to its own parts distribution network, Shimano has built an extensive network of bike shops under contract in major cities serving as “Shimano Service Centers,” whereby it can provide a broader array of repair parts more quickly to those bike shops.

Fit Across Activities
Continuous functional improvements and frequent introductions of new products are key to ensuring the success of Shimano’s strategy of functional differentiation through the development of systematized components. Shimano supports this strategy by conducting marketing activities to communicate the value of the product and offering training on adjustment methods and techniques for repairing new products, as well as by ensuring a supply of spare parts. Shimano creates opportunities for direct communication with end-users by hosting various events, undertaking team sponsorship, and extending support to bike shops. This direct feedback from people in the field helps the staff to generate ideas for product development and provides them the opportunity to communicate to a wide variety of users the distinct advantages of Shimano’s product features. Furthermore, by hosting events and sponsoring a team, the company can enhance its brand equity while creating a broader base of support among bicycle sports fans.
Shimano’s commitment to the two different markets of road racing and mountain bikes provides the opportunity to leverage the technologies of one market for application in the other market. For example, the company’s sealing technology for protecting against mud and dust was originally developed for mountain bikes. This technology was later transferred to road-racers for the European market, where racers must endure far worse road surfaces and weather conditions than racers in the U.S.

Seeking a demand-pull from end-users, Shimano focuses on identifying end-users’ needs and responding to those specific needs. It does not accept requests for the manufacturing of dedicated components, nor will it undertake batch production of special components for individual manufacturers of assembled bikes. Adhering to such a policy serves to reduce the burden on the company’s development and production capacity. Unlike in the development of parts as discrete units, the complexity is multiplied in the development of parts as systemized components.

(Please refer to the “Activity System Map” attached for a more detailed account of the relationship among these activities.)

**Innovations that enable the strategy**

- In the global bicycle parts industry, each part was treated traditionally as a physically discrete unit but one that was commonly shared in a standardized interface established by parts manufacturers, who specialized in a specific area. Shimano changed all that by designing and developing systematized components for such features as gear shifts, brakes, and power drive mechanisms using its own proprietary interface (i.e., the company systematized various discrete parts, making them into a single component.)
- Shimano created and developed a totally new mountain bike market.

**Continuity of Strategy**

Since commencing production and sales of parts for road-racing bicycles in 1973, Shimano has continued to dominate the high-performance bike market with the fruits of its ongoing technology development efforts. Shimano began creating special parts for the development of systematized components in 1973, and the company continues to follow this strategy today. In recent years, Shimano has been working on gearshift systems incorporating automated electro-mechanical solution. This is one example of the company’s efforts to achieve a high performance and superior ease of handling and comfort for end-users.

**Trade-off**

- Shimano does not seek to maximize the performance of a single part.
● It does not develop and manufacture components, such as saddles and tires, for which systematization would not improve its performance.
● Shimano delivers value to end-users in the form of a system, and therefore it does not sell discrete parts on the market.
● Shimano does not engage in OEM arrangements, whereby dedicated parts or systems are displayed under the brand of an assembled bike manufacturer.
● Shimano does not produce assembled bicycles. Manufacturers of assembled bikes are customers for Shimano, which is a manufacturer of parts and components.
● Shimano does not rely on trading firms or middlemen in its distribution process, primarily to ensure sufficient training to bike shops regarding Shimano’s product features, installation and repair methods.
● Shimano does not independently conduct mass-marketing activities.

Profitability
Shimano achieves a much higher return on invested capital and return on sales than the bicycle parts industry average.

Return on Invested Capital (ROIC): Bicycle Components Division, Shimano Inc.

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Return on Sales (ROS)

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<td>15.3%</td>
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</table>
Activity System Map--- Bicycle Components Division, Shimano Inc.

- Skunk activity (e.g., testing by expert users)
- Quality-control based on thought processes, reviews as a system
- Refusal to make components that cannot lead to performance improvement through systematic integration
- Repair parts supplied through Shimano Service Centers
- Refusal to enter assembled bicycle business
- Frequent development and introduction of new products
- Elaborate new product launch activities
- Identification of market needs
- Creation of new markets and expansion of existing markets
- Hosting of Dealer Caravans and new product presentations
- Identification of market needs
- Team sponsorship
- Sponsorship of events and dispatch of mechanics to races
- Direct appeals to bike lovers
- Refusal to make OEM products bearing customer’s name
- Won recognition of Shimano as a high-performance brand
- Branding by product lineup
- Pursuit of better features, performance and comfort for bicycles
- Adoption of systemized components as product structure
- Refusal to make components that cannot lead to performance improvement through systematic integration
- Functional compatibility that exceeds bike category (type of bicycle)
- A cascade strategy, with development targeted at the high-end market
- Cultivation of trust in relationships with dealers
- Hosting of Dealer Caravans and new product presentations