

# Porter Prize

## Winners Selection Rationale

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This report has been written based on: (1) the materials submitted by the winner for Porter Prize screening purposes; (2) interviews conducted by the Porter Prize Organizing Committee; and (3) publicly available information. It is being published with the winner's permission.

### 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 profitability
2. Unique value proposition
3. Consistency of Strategy over Time
4. Innovation that Enabled 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 placed on ROIC (Return on Invested Capital) and ROS (Return on Sales). The following report of the winners includes these numbers in comparison with the industry averages. A positive difference from the average indicates that the capital utilization of the company/business is better than the industry average. The five-year average is calculated by aggregating the numerators divided by the aggregated denominators. Thus, the derived five-year average is not equal to the simple average of the ratio for each year. The data used in calculating the industry average was obtained by carefully selecting truly comparable companies among those classified as being in the same industry.



Organizing Committee

Hitotsubashi University Business School  
School of International Corporate Strategy

Sponsor

Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.

<https://www.porterprize.org> E-mail: [porterprize@ics.hub.hit-u.ac.jp](mailto:porterprize@ics.hub.hit-u.ac.jp)

# Porter Prize 2013 Winners

Organizing Committee  
Graduate School of International Corporate Strategy, Hitotsubashi University  
2013 Sponsors  
The Bank of Tokyo-Mitsubishi UFJ, Ltd.  
PwC Japan

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**ITO EN, LTD.** (Tea leaf and beverage manufacturer and distributor)

ITO EN has created a sugar-free drink market in Japan by focusing on green tea drinks in cans and PET bottles. It has a unique value chain, strengthened by a comprehensive product line of green tea drinks, a route sales system, and a tea-producing region development project.

**Kakaku.com, Inc., Kakaku.com Business Unit** (Prices comparison site)

Kakaku.com succeeded in establishing a price comparison service as a business. It puts clear priority on the consumer's benefit, while simultaneously providing an indispensable service for retailers and manufacturers.

**Mitsubishi Corp. – UBS Realty Inc., Industrial Division**  
(Industrial & Infrastructure Fund Investment Corporation)  
(Real Estate Investment Trust/REIT management)

Supports the securitization of industrial real estate held by Japanese companies, with the aim of helping to revitalize the Japanese economy

**UNITED ARROWS LTD.** (Apparel retailer)

UNITED ARROWS LTD. has succeeded in developing the “select shop” business on a large scale. It carries high-quality products, purchased items as well as original products.

## Selection Rationale (Recipients are addressed in no particular order):

### ITO EN, LTD.

ITO EN has created a sugar-free drink market in Japan by focusing on green tea drinks in cans and PET bottles. It has a unique value chain, strengthened by a comprehensive product line of green tea drinks, a route sales system, and a tea-producing region development project.

### Industry Background

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The Japanese soft drink market has been growing because of increasing health consciousness and frequent heat waves during the summers. Meanwhile, competition in the industry has been intensifying, and price competition has become more prevalent as a result of the protracted economic slump and reduced spending by budget-minded consumers. The Japanese green tea drink market, which peaked in 2005, has been shrinking until the recent recovery. It reached 383 billion yen in 2012 (according to ITO EN's Performance Report for the fiscal year ended April 30, 2013).

### Executive Summary

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ITO EN is a unique beverage company that focuses on drinks made mostly of natural ingredients. It does not include alcoholic beverages in its product line. Out of the company's 5,307 employees, 4,000 are sales staff, mostly assigned to 201 local sales offices. Sales staff members introduce the products which they regard as most appropriate for each retailer, selected from the company's comprehensive product line. They also make efforts to understand customers' needs. The R&D department, which specializes in tea blending and manufacturing, strives to meet those customer needs through its product development activities. Partner factories scattered across Japan manufacture ITO EN's products, leveraging their unique competencies. ITO EN makes it a priority to help Japanese tea farmers improve their productivity. As a result, ITO EN can enjoy a stable supply of high-quality tea leaves. The company holds a 37% share of the green tea drinks market in Japan, and accounts for a 45% share among the top seven manufacturers, according to ITO EN's Performance Report for the fiscal year ended April 30, 2013.

### Unique Value Proposition

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ITO EN's value proposition is natural, healthy, safe and tasty drinks (and tea leaves). Its target customers are individuals who want natural, healthy and safe drinks, and this customer segment is broad in terms of ages and genders. ITO EN's product line consists of drinks that are made primarily from natural ingredients, such as Japanese Tea Beverages Oi Ocha, Kenkou Mineral Mugicha (healthy mineral barley tea), Chinese Tea Beverages Oolong Tea, Vegetable Beverages Jujitsu Yasai (Vegetables Galore) and Ichinichibun no Yasai (A Day's Worth of Vegetables), Fruit Beverages Vitamin Fruit, Coffee Beverages Tully's Coffee, Black Tea Beverages TEAS' TEA, and Mineral Water evian. Sales of the products in these product categories accounted for 84.4% of the company's total sales in the fiscal year ended April 30, 2013. Other products include the Functional Beverages Kurozu to Moromisu (black vinegar and unrefined sake vinegar), Lactic Acid Bacterium Beverages, Sports Drinks, Carbonated Beverages, Food Beverages, and Tea Leaves. The company does not have alcoholic beverages in its product line. It has the broadest product line in the green tea beverages segment, which includes a variety of products sold under the Oi Ocha brand — Oi Ocha Ryokucha (Green Tea), Oi Ocha Koi Aji (Dark), Oi Ocha Hojicha (Roasted Green Tea), Oi Ocha Genmaicha (Green Tea with Roasted Brown Rice), and Oi Ocha Zokkon (Cherished Blend). These products are available in different types of containers, such as cans, paper cartons, PET bottles, and hot-fill PET bottles, and in different sizes (2 liters, 500 milliliters, 200 milliliters, etc.).

Soft drinks were often sold at a discounted price in supermarkets. Price competition extended to vending machines, which had been selling soft drinks at the manufacturer's suggested retail price for many years. ITO EN has been able to minimize the impact of price competition through the following means: First, it offers an extensive variety of products in the green tea segment, thereby meeting the specific needs of different retailers (i.e. small-sized cans for tiny shops operating in parks). Second, it places its products at a distance from other beverages. For example, it provides convenience store chains with heated cases (enabling the sale of warm drinks), and these cases are placed next to cash registers. Consequently, ITO EN's products can avoid head-to-head competition with the products of competitors. Third, a successful branding strategy allows the company to keep its prices at a higher level. In the case of coffee drinks, for example, ITO EN has leveraged the brand equity of Tully's Coffee Shops by introducing a Tully's brand can of coffee that sold for 130 yen at a time when competitors were charging 120 yen. ITO EN has been able to keep its price at 130 yen.

## Unique Value Chain

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ITO EN's value chain is unique in terms of its procurement, product development, manufacturing, marketing and sales functions, and the high degree of consistency across functions. Below, the company's value chain is explained focusing on green tea drinks, which account for nearly half of the company's total sales.

### **Procurement**

Green tea products account for 46.3% of ITO EN's total sales, and its main product brand, Oi Ocha, uses only domestically produced tea leaves. Consequentially, ITO EN handles one-fourth of all the unprocessed tea leaves produced in Japan. The company has strong bargaining power in the negotiation of the purchasing price because of its scale. Meanwhile, land area under cultivation for tea leaves has been declining in Japan. ITO EN has launched the Tea-Producing Region Development Project. This project is being undertaken in collaboration with farmers and local governments in Japan. Through this project, the company helps experienced and new farmers to improve their productivity by providing them with the know-how for using machinery and ICT in farming operations. It also signs contracts with participating farmers to buy all the tea leaves they produce. This project supported 863 hectares of land under cultivation (with the contract tea plantation area accounting for 542 hectares, and the new tea plantation area comprising 321 hectares) in fiscal year 2012. The 863 hectares covered by this project accounted for 13.2% of the total amount of unprocessed tea leaves the company procured in fiscal year 2012. As a result of this project, ITO EN can ensure a more stable supply of tea leaves that are higher in quality, while farmers can realize improved productivity.

### **Manufacturing**

The roasting and blending of tea leaves is undertaken primarily at ITO EN's Sagara Plant in Shizuoka. The abstraction and bottling processes that follow are outsourced to bottlers (packers). By outsourcing these processes, ITO EN is able to minimize investment in plants and equipment, while maximizing the flexibility for making adjustments in the manufacturing volume to accommodate fluctuations in demand and for selecting manufacturers by their unique competencies and the innovations they have achieved amid intense competition.

### **Research & Development**

ITO EN focuses its research activities on tea leaves and tea drinks, starting with basic research and extending to blending techniques and manufacturing technology, which are often patented. Not only has ITO EN's success in R&D enabled the company to offer a greater variety of products and packages, it has allowed ITO EN to become the first in the world to commercialize canned oolong tea drinks and canned green tea drinks. These achievements were made possible through manufacturing innovations, such as a technique for preventing the oxidation of tea in the can-filling process. The company also has a unique patenting strategy for green tea drinks.

ITO EN aggressively adopts technological innovations created by outside bottlers. Such innovations

have resulted in hot-fill PET bottles (an industry-first) and a new filling system—a non-sterilant system that has a lower environmental impact and does not require the use of sterilizers.

ITO EN's R&D activities involve the recycling of used tea leaves. The company generates 49,000 tons of used tea leaves, which is as much as the waste that the city of Nagoya processes in one month. Most of the used tea leaves are used as fertilizer and fodder. However, it does not make economic sense in the case of used tea leaves sent from the bottlers located in the metropolitan areas, given the transportation and drying costs involved. Thus, ITO EN started working on the development of its Used Tea Leaves Recycling System in 2001. Now, the company recycles used tea leaves, and this recycled pulp is used in paper products, boarding, resins, and building materials, thereby eliminating the expensive process of drying. The cardboard boxes developed with Rengo (a leading packing company) include used tea leaves as a material. About 25 million of these cardboard boxes are produced a year. This volume is equivalent to a year's worth of cardboard cases for Oi Ocha, with one cardboard case containing 24 bottles (500 milliliters) of Oi Ocha.

### **Marketing & sales**

To get its products onto store shelves, ITO EN relies less on advertising expenses and more on its own sales force. Four thousand salespeople—all of them full-time employees and most of them assigned to 201 local sales offices across the country—visit retailers to explain product features, sell, and deliver products. Each salesperson proposes a customized selection of products to retailers, taking into consideration the retailer's or vending machine's location (office buildings, street-facing locations, train stations, parks, tourist spots, factories, construction sites, nursery schools, schools, elderly homes, hospitals, and transportation facilities) and target customers (gender and age). They also try to understand emerging customer needs through direct communication with retailers and consumers. Information on market needs is collected through a proposal system—the “Voice System”—and is used in new product development.

### **Human resources management**

ITO EN instills in its staff the understanding that each individual employee is responsible for conducting marketing. It has created an original program—the Tea Taster Qualification System—to give recognition to those employees with an extensive knowledge of tea. Out of a workforce of 5,300 employees, 1,460 employees hold some kind of qualification (four employees have achieved the first-level degree, seven the “jun” (quasi) first-level degree, 210 the second-level degree, and 1,239 the third-level degree.)

## **Fit among Activities**

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ITO EN's procurement capabilities have helped it to achieve access to a stable supply of high-quality tea leaves. It also effectively leverages its own internal competence in R&D and the manufacturing technology of the bottlers. These strengths support the company's comprehensive product line in the tea drinks product category. This comprehensive product line has been utilized by sales staff in route sales, who prepare customized lists of proposed merchandise for retailers, to meet local customer needs and preferences, and also to avoid price competition. The sales staff members involved in route sales also contribute to the idea generation process for new product development. (Please refer to ITO EN's activity system map, which appears at the end of this report.)

## **Innovation that Enabled Strategy**

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- The world's first canned oolong tea (launched in 1981).
- The world's first canned green tea (launched in 1985).
- The industry's first hot beverages sold in PET bottles (introduced in 2000).

## Trade-offs

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- Does not have its own bottling facilities.
- Does not conduct animal experimentation.
- Does not include alcoholic beverages in its product line.
- Does not outsource route sales.
- Does not use any flavoring additives or fragrances in its green tea drinks.

## Consistency of Strategy over Time

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ITO EN's has been working to create new markets through technological innovation. Its predecessor, a tea leaf seller, created a market for tea leaves in supermarkets, which did not carry loose tea leaves, and succeeded in developing a new package with an aluminum coating that would keep the tea leaves dry. (The standard practice in those days was to measure out tea leaves and sell them by weight.) Next, ITO EN entered the ready-to-drink market with the introduction of the world's first canned oolong tea drink in 1981. In 1985, it launched the world's first canned green tea drink following the development of a manufacturing innovation that prevents oxidation during the can-filling process. This has created a market for sugar-free drinks in Japan. In 1990, it introduced the world's first green tea drink in a PET bottle. This was followed by the introduction of hot drinks in PET bottles in 2000. Route sales that supported these innovations from marketing and sales have been in use since 1968, when the company opened its first branch office in Yokohama.

ITO EN has broadened its product lineup, adding black tea drinks, coffee drinks, vegetable and fruit drinks and mineral water products. Its value proposition, however, has remained unchanged—natural, healthy, safe and tasty drinks. The company's expansion of its product range is highly consistent with its route sales and the outsourcing of the manufacturing function to bottlers.

## Profitability

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Both return on invested capital and return on sales far exceed the industry average.

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 4.2%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	4.4%P	3.4%P	6.3%P	4.1%P	4.6%P

Inter quartile range (IQR) = 6.9%P

Return on invested capital = Operating income / Average invested capital

### Return on sales (ROS)

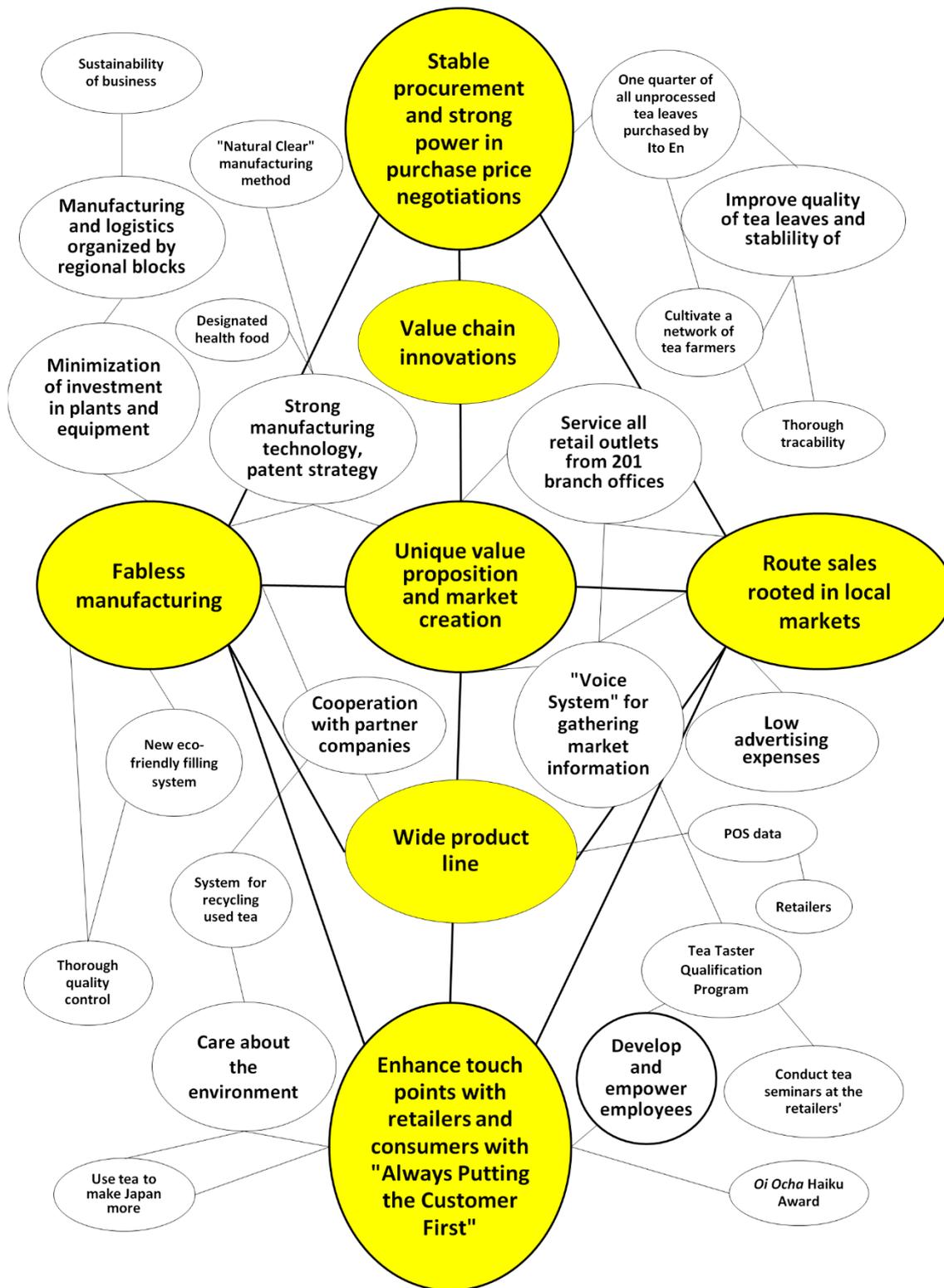
(Unit=percentage point)

Difference from industry average over 5 year period 1.1%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	1.4%P	0.3%P	1.6%P	0.9%P	3.0%P

IQR = 3.6%P

Return on sales = Operating income / Net sales

Activity System Map of ITO EN, LTD.



## Selection Rationale (Recipients are addressed in no particular order):

### **Kakaku.com, Inc., Kakaku.com Business Unit**

Kakaku.com succeeded in establishing a price comparison service as a business. It puts clear priority on the consumer's benefit, while simultaneously providing an indispensable service for retailers and manufacturers.

#### Executive Summary

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Kakaku.com is a search engine that specializes in shopping support for such merchandise as personal computers, household appliances, cameras, and telecommunication services such as broadband access and mobile phone subscriptions. It provides information that includes product specifications, prices, and consumer evaluations, helping others to decide which product to buy from which retailer. It attracts more than 45 million visitors per month, with more than 948 million page views per month (in October 2013). Kakaku.com launched its service in April 1997, and not only is it the pioneer of price comparison sites, it has achieved an overwhelming dominant position in the market in Japan.

#### Unique Value Proposition

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Kakaku.com's target customers are individuals thinking about buying some kind of product, either online or offline. It serves a diverse customer base, in terms of their genders, ages and residential areas.

Kakaku.com provides "neutral" and "reliable" information, and through such information, it enables users of its service to decide for themselves which product to buy. "Neutral" information means that Kakaku.com, when listing product information, does not differentiate products with advertisements from those without advertisements. "Reliable" information means that the company filters out postings containing malicious intent. The company also monitors retailers listed on its website for their reliability to ensure that users will not fall victim to online scams. In addition, the company selects information putting the user's benefit first. The company lists retailers by their retail price (from cheapest to most expensive) for a specific product. It also shows critical evaluations posted by consumers, which appear to be a disservice to the retailers and manufacturers that pay for the services of Kakaku.com.

The company explains its value proposition—helping people to decide which product to buy—in its mission statement:

The moment of satisfaction is what we offer.

Find the best match for your needs, in the most reasonable way.

Tell others about your unique shopping experience at Kakaku.com.

Retailers and manufactures who purchase an advertisement at Kakaku.com can reach a large number of Kakaku.com users, who are strongly motivated and highly likely to make a purchase. In order to reach these users, retailers and manufacturers place advertisements (Kakaku.com's first source of income); they list their retail prices and provide a link to their website in order to direct users to their websites (Kakaku.com's second source of income). Kakaku.com charges retailers and manufacturers each time a user clicks a link. Through Kakaku.com, small retailers with a niche focus can acquire customers at a low cost.

As a third source of income, Kakaku.com provides agency services to its users on behalf of Internet Service Providers and insurance companies. The agency service is positioned as an extension of the price comparison service because Kakaku.com receives a commission when users purchase the ISP service or an insurance product at Kakaku.com after comparing prices and checking other product information at Kakaku.com.

## Unique Value Chain

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Its value chain focuses on enabling customers to make a reliable and easy comparison.

### **Data development and data presentation**

Kakaku.com has developed a product database based on a unified scheme of specifications for better comparability. This process, although it enables Kakaku.com to present information in a unified format, involves a labor-intensive data entry process. It would be much easier to just copy and paste in the information provided by manufacturers and retailers, or use software to search the Internet to collect price information.

Information presented in a unified format results in better quality word-of-mouth evaluations by consumers because they are making comments based on a correct understanding of the basic information on those products and services.

Kakaku.com provides retailers with software so that they can directly input their own retail prices and indicate inventory information (i.e., product availability). This results in the almost real-time updating of retail information.

Consumers, meanwhile, post word-of-mouth reviews.

Kakaku.com makes comparisons easier by categorizing together similar products, as well as by allowing consumers to drill down the details regarding product specifications.

### **Quality control**

Kakaku.com maintains the quality of the information posted by monitoring consumer postings 24 hours a day. It also monitors retailers, and sometimes even visits their premises, to assess their reliability.

## Fit among Activities

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Kakaku.com business unit's activity systems are selected and coordinated around such strategic choices as "create a receptacle for information," "accumulate information," and "make it easier to find information." (Please refer to Kakaku.com's activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Kakaku.com was one of the early adopters of consumer-generated content. This company is unique in its commitment to maintaining the quality of consumer-generated content. (For example, it monitors customer postings 24 hours a day.)
- Kakaku.com's unique database, which provides a solid foundation for the business, makes it easier for consumers to compare products and services.

## Trade-offs

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- Does not put retailers and manufacturers ahead of consumers. Kakaku.com has maintained its commitment to the provision of neutral and reliable information for consumers, even after the website began posting advertisements by retailers and manufacturers.
- Does not try to make a quick profit. Rather than focus on sales and profits, the company places a top priority on attracting more visitors. To do this, the company focuses on increasing the amount of consumer-generated information, and ensures that such information is reliable and relevant.
- Does not corral consumers. It does not employ such tactics as membership or point systems.

- Does not put emphasis on search engine marketing. (In the case of search engine marketing, advertisements are placed through the purchase of certain key words). Rather, it puts emphasis on search engine optimization, achieved through the diligent accumulation of content.
- Does not expand its business beyond shopping support services. Although Kakaku.com obtains information on consumer behavior and the retail business, it does not provide consulting services because such services are too labor intensive.

## Consistency of Strategy over Time

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From its start, Kakaku.com has been putting users first. It has been posting information that could work against retailers and manufacturers, but by doing this, it has won the trust and support of its users. This could have resulted in the loss of business opportunities with retailers and manufacturers for several years. But retailers and manufacturers eventually recognized the value of Kakaku.com's service, and started to pay for its services. Also, Kakaku.com has been employing a consistent approach. When it started out, Kakaku.com posted price information and word-of-mouth evaluations for personal computers. Retailers and manufacturers objected to such postings. However, more and more consumers have begun referring to Kakaku.com before buying personal computers. Over time, the number of retailers and manufacturers that have started to recognize the value of this service has grown.

## Profitability

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Both return on invested capital and return on sales exceed the industry average by a wide margin.

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 56.7%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	66.2%P	52.9%P	57.6%P	43.6%P	40.0%P

Inter quartile range (IQR) = 30.8%P

Return on invested capital = Operating income / Average invested capital

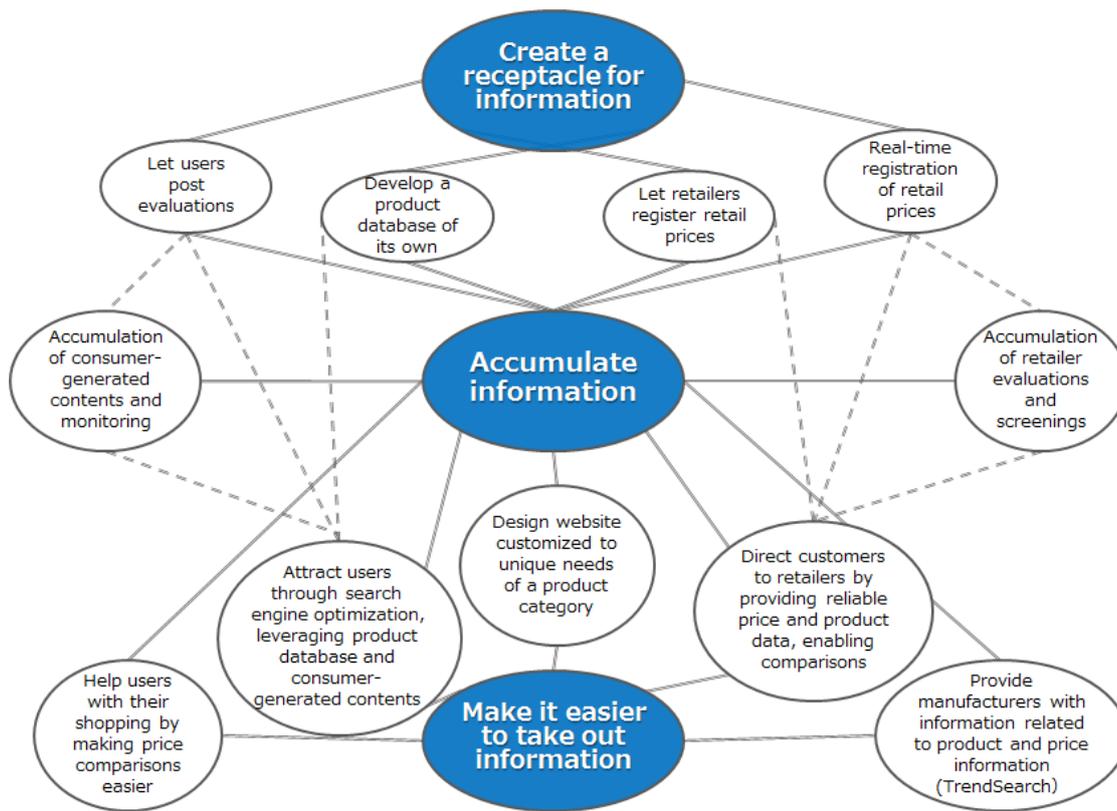
### Return on sales (ROS)

(Unit=percentage point)

Difference from industry average over 5 year period 45.4%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	47.3%P	44.9%P	44.8%P	41.2%P	41.5%P

IQR = 19.5%P

Return on sales = Operating income / Net sales



## Selection Rationale (Recipients are addressed in no particular order):

### **Mitsubishi Corp. – UBS Realty Inc., Industrial Division (Industrial & Infrastructure Fund Investment Corporation)**

Supports the securitization of industrial real estate held by Japanese companies, with the aim of helping to revitalize the Japanese economy

#### Executive Summary

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Mitsubishi Corp. – UBS Realty Inc.’s Industrial Division manages the Industrial & Infrastructure Fund Investment Corporation (hereafter, IIF), which is the first and only J-REIT that focuses on industrial and infrastructure properties, such as logistics centers, factories, R&D centers and data centers owned by companies and local governments. IIF was listed on the Tokyo Stock Exchange in October 2007.

Other J-REITs usually own residential apartments or office buildings. Some REITs might own logistics centers, but they rarely own industrial properties, such as R&D centers, data centers, and maintenance centers for airline companies, like IIF does.

When IIF purchases an industrial property from a company, it takes ownership and then leases back the property to the previous owner so that it can continue using that same property. IIF also provides maintenance services for the property being leased. After taking the ownership of a property, IIF securitizes the ownership and creates a REIT, which is sold to investors through public offerings.

Mitsubishi Corp. – UBS Realty Inc. was established in 2000 as a 51:49 joint venture between Mitsubishi Corporation and UBS AG, one of the world’s largest real estate investment managers.

#### Unique Value Proposition

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In the mission statement for IIF, Mitsubishi Corp. – UBS Realty Inc. declares that its mission is to “support Japan’s economic activities by investing in social infrastructure, which forms the base for economic growth.” It is very unusual for the mission statement of a REIT to mention “social value.”

Those companies that have sold real estate to IIF can continue their operations on the same property by paying a lease expense. This arrangement also allows them to obtain cash, which they can invest in their core business activities. If the sales price is higher than the book value, they can realize a profit from the sale of the property. They can also improve their balance sheet. The rents would remain stable, as most rent contracts offer fixed rent rates (the average rental contract period for tenant companies is longer than 13 years). Companies might be able to sell a property to an entity with a specified investment time period, but that entity might sell the property to others. In such case, the tenant faces the risk of not being able to continue using that property. In contrast, IIF is a listed REIT which is a closed-end fund without specified maturity or redemption date, allowing tenants to expect a long-term ownership by IIF and the right to continue using that property over the long term. Tenant companies can also confirm the financial stability of IIF, which affects the likelihood of continuous use, through IIF’s extensive investor relations activities and the disclosure of such information as profitability, obtained properties, occupancy rates, and rental income. Tenants can also outsource non-core business activities like property maintenance because IIF provides such services as the property’s owner.

IIF conducts a global offering, and has non-Japanese investors as customers. Owners of the IIF REIT units enjoy continuous dividends and capital gains (so far, the IIF REIT’s price has been increasing). IIF’s total return (dividends + capital gains) is one of the highest among J-REIT products. IIF’s occupancy rate is extremely stable, and it also generates a consistent level of rental income. IIF’s occupancy rate in January 2013 was 100%, while the average occupancy rate for residential properties was 96.6%, logistics centers was 97.2%,

and offices was 95.1%. IIF's rental income in June 2013 was 97.9% of the July 2008 level, while the average rate of rental income from residential properties was 96.4%, logistics centers was 93.8%, and offices was 71.6%.

## Unique Value Chain

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Its value chain is very different from those of other J-REITs because the industrial properties in which it invests do not have high liquidity levels like the residential, office and retail properties in which other REITs invest. This uniqueness is reflected in its property searches, procurement activities, and operations.

### **Procurement of properties**

Mitsubishi Corp. – UBS Realty Inc. defines “continuity” and “versatility” as the property selection criteria. Because the profitability of real estate investment depends on occupancy rates and rent income, it is preferable that the property will continue being used by the previous owner. If a tenant company decides to stop using a property, ideally that space should be leased to another corporate tenant at the same rental rate (versatility). Mitsubishi Corp. – UBS Realty Inc. conducts a thorough preliminary analysis of a property prior to its acquisition. The owner company must be operating in an industry with an industry structure good enough to warrant a long-term commitment to the facility. In addition, the owner's earnings performance should be solid, and the facility should be important to the owner. In addition to an internal screening conducted by Mitsubishi Corp. – UBS Realty Inc., a third company will examine prospective property to assess its continuity and versatility, and reports containing the results of this examination are published for investors.

Because there was no market for corporate real estate in Japan in 2007 when Mitsubishi Corp. – UBS Realty Inc. created the IIF, the company had to search for potential sellers and educate them about the benefits that the securitization of real estate property provides to an owner company's management. It had to help customers understand the need for securitization. Through this process, the company creates a win-win relationship while also creating value for property sellers. This results in a negotiated transaction, not competitive bidding. Now that the securitization of real estate property has become an established practice in Japan and REITs (including the IIF) have become well known, more customers are knocking on Mitsubishi Corp. – UBS Realty Inc.'s door.

### **Procurement of capital**

IIF finances itself through public offerings, bank loans, the selling of properties on hand, and cash in hand. Sometimes, Mitsubishi Corporation provides bridge funds. The IIF's long-term preferential debt is rated as AA (stable, as of August 6, 2013) by the Japan Credit Rating Agency, Ltd. (JCR).

### **Fund administration**

The average rent contract period between IIF and tenants is over 13 years, and the vacancy rate has been kept below 0.1% continuously. This has resulted in a stable cash flow. Cash outflow happens when IIF conducts maintenance services on the properties. However, cash outflow is stable because IIF has tenants make arrangements for long-term maintenance plans. IIF maintains close communication with tenants, which contributes to their long-term leasing.

### **Marketing & sales**

IIF conducts extensive investor relations activities in order to communicate the unique risk characteristics of this REIT compared with other J-REITs. It attracts investment from outside Japan by conducting a global offering, which is unique among J-REITs.

### **Human resources management**

In contrast to other J-REITs, where people on loan from parent companies dominate the operations, Mitsubishi Corp. – UBS Realty Inc. recruits experienced professionals with specialized expertise.

## Fit among Activities

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The activities of Mitsubishi Corp. – UBS Realty Inc.’s Industrial Division are selected and coordinated around one key strategic choice, namely, the decision to focus on industrial real estate. The core activities are: 1) making proposals to property owning companies regarding the creation of value through corporate real estate (CRE), with the aim of purchasing those properties; 2) raising funds and managing investors; and 3) undertaking fund administration. These three core activities are handled by employees with expertise in this field. (Please refer to Mitsubishi Corp. – UBS Realty Inc. Industrial Division’s activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Unique target market, i.e., industrial real estate properties. (Since IIF’s listing in 2007, no other J-REIT has invested in industrial real estate.)
- It reduces risk for fund operating companies by securitizing those properties, rather than just taking ownership and leasing back those properties. Securitization also allows for more rapid expansion in size by making financing easier.
- Application of this business concept to public real estate (PRE). IIF created a tool by which public entities can sell their real estate holdings and improve their balance sheet. (Specifically, in January 2013, IIF bought the land on which a logistics center was operating, and changed the name to the “IIF Kobe Logistics Center.”)

## Trade-offs

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- Does not invest in office buildings, residential apartment buildings, or retail buildings.
- Does not buy from the market. Does not participate in competitive bidding.
- Does not offer private placement funds. Although a private placement fund is more flexible, Mitsubishi Corp. - UBS Realty Inc. prefers the transparency and permanence of REITs.
- Does not purchase real estate solely from its sponsor companies or any other specific pipelines.

## Consistency of Strategy over Time

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Mitsubishi Corp. – UBS Realty Inc.’s Industrial Division has three core consistencies. The first is its focus on investment in industrial real estate. When the Industrial Division listed IIF in October 2007, IIF had eight logistics centers and one infrastructure (worth 66 billion yen in total). However, IIF had to wait until 2010 to be able to purchase real estate through CRE strategy proposal activities. There were no precedents, and companies had difficulty accepting the Division’s proposal. The company’s epoch-making achievement occurred in 2010, when IIF purchased an R&D facility from Taisei Corporation. This facility was later renamed IIF Totsuka Technology Center, and was leased back to corporate tenants with a long-term fixed rental contract. This raised Japanese companies’ awareness regarding IIF. Since then, IIF has been adding alternative methods, such as the securitization of newly developed properties with long-term tenants and the purchase of real estate from public entities, while maintaining its primary focus on industrial real estate.

The second core consistency is the procurement of real estate through CRE proposals. Representatives of the Industrial Division talk directly with property owners, make proposals on how to create more value from their real estate, and purchase the properties directly from the owners. The Industrial Division can thus avoid paying the premiums that often accompany competitive bids.

The third core consistency is the commitment to its own screening criteria, which are “continuity” and “versatility.” Not only are these criteria applied in all cases—the Industrial Division also asks a third-party to evaluate the properties based on these criteria and publish the results.

## Profitability

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### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 1.9%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	1.5%P	1.6%P	2.1%P	2.1%P	3.1%P

Inter quartile range (IQR) = 0.4%P

Return on invested capital = Operating income / Average invested capital

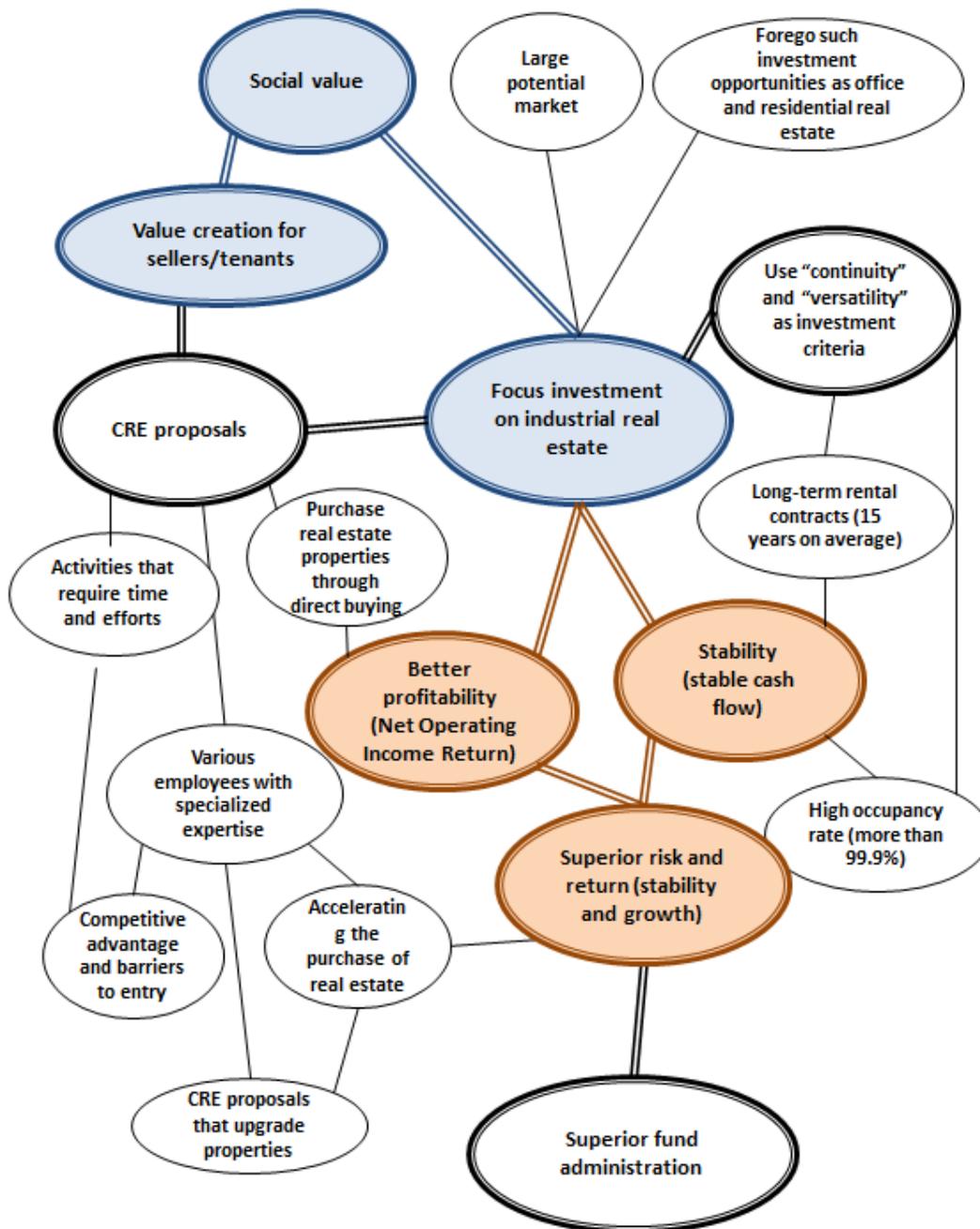
### Return on sales (ROS)

(Unit=percentage point)

Difference from industry average over 5 year period 5.4%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	-0.8%P	-1.7%P	2.6%P	5.7%P	13.8%P

IQR = 5.3%P

Return on sales = Operating income / Net sales



## Selection Rationale (Recipients are addressed in no particular order):

### UNITED ARROWS LTD.

UNITED ARROWS LTD. has succeeded in developing the “select shop” business on a large scale. It carries high-quality products, purchased items as well as original products.

#### Executive Summary

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UNITED ARROWS LTD. (hereafter, UA LTD.) is Japan’s largest “select shop” apparel company, with sales of 100 billion yen (US\$ 1 billion) and 220 stores. The term “select shop” refers to apparel retailers that carry both original products and purchased products. Examples of well-known select shops are Colette of France and the U.S. apparel retailer Opening Ceremony. Industry observers have noted that it is very difficult to expand select shops from several stores to a chain encompassing hundreds of stores because, for select shops, merchandising is the key to success, and the degree to which merchandising is successful depends largely on the owner.

#### Unique Value Proposition

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UNITED ARROWS LTD. targets customers who are interested in fashion, rather than those who give priority to utility or price. Calling this segment a “trend market,” UA LTD. considers it to be “a half-step ahead of mainstream customers.”

UA LTD. has 17 different brands, targeted at different price ranges. At the highest end (in terms of price), it operates the Chrome Hearts brand of silver accessories and leather goods. In the second-highest price range in the trend segment, it has two brands: UNITED ARROWS, and BEAUTY&YOUTH UNITED ARROWS. In the middle price range in the trend segment, it has the UNITED ARROWS green label relaxing brand, offered in a price range that is 30% lower than UNITED ARROWS brand items.

Under each brand, UA LTD. offers a wide range of products, and covers everything from men’s and women’s formal and casual clothing to silver and leather accessories, as well as general merchandise. (The only exception is Chrome Hearts. UA LTD. is the importer and retailer of this established overseas brand.) In terms of fashion taste, UA LTD.’s brands cover the spectrum of classic, mode, elegance, natural, and basic styles.

This value proposition is unique because most apparel brands focus on a particular customer segment (targeting a specific gender, age range or fashion taste). UA LTD. manages its brands according to price range. (Its brands span the mid-price to middle-to-high price ranges). Each brand selects its target segment according to price and fashion taste, and offers a broad product line to meet various customer needs.

UA LTD. provides customers with a fun shopping experience that celebrates the joy of living while also imbuing a spirit of richness. The three key sources of satisfaction for UA LTD. customers are: “Great Service (customer service),” “Great Products (the merchandise),” and “Great Environment (the stores).” Customers choose UA LTD. brand items because the products are “a half-step ahead” of the prevailing taste in fashion, and because of the superior customer service in stores. The company declares “It’s All About The Customer,” and provides finely tuned customer service. At the same time, the company spends considerable amounts on interior design to create a sophisticated shopping atmosphere while providing facilities, spaces, and environments that deliver genuine comfort and a sense of fun.

UA LTD.’s corporate policy is to “Create a New Japanese Standard.” In other words, the company endeavors to create new standards for the Japanese lifestyle. It seeks to offer world-class value by seamlessly combining Japanese culture and traditions with those of the west. In line with this corporate philosophy, UA LTD. offers a wide product lineup and proposes a lifestyle that “stays a half-step ahead.”

## Unique Value Chain

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UNITED ARROWS LTD.'s value chain is unique in its visualization and standardization of operations throughout the entire value chain. Activities range from the procurement of purchased products and the manufacturing of original items to store deliveries and inventory clearance. Its value chain is unique in terms of the merchandising and in-store sales activities, because of the wide range of items UA LTD. offers.

### **Merchandising**

UA LTD.'s product development policy calls for a "Trad Mindset." In other words, a deep respect for history and heritage, coupled with an innovative approach, which drives the creation of new traditions. In line with this product development philosophy, the company's basic product policy is defined. Then, the basic policies for product development, merchandising philosophy, and the product cycle are determined. In each season, the company develops a company direction, which defines the merchandising of all the brands. Each brand director sets the brand direction in accordance with the company direction, so that all the brands from UA LTD. propose a unified theme to customers.

UA LTD. has internalized the design function (clothing design, materials development, and pattern creation) to maintain the high quality of its original products. Designers accompany buyers on their trips overseas to research fashion trends. The company keeps samples of materials and designs in the Creative Resource Center, and in a separate "atelier" designers can develop samples.

UA LTD. tries to control the ratio of original products to purchased products to achieve a targeted proportion that is set for each brand. The in-house developed "MD Platform" management system facilitates the development of weekly merchandising plans for one year (52 weeks) and the control of inventories. The MD Platform management system shows scores on key performance indicators, and indicates the business results in progress charts. This is undertaken for all brands, to enable comparisons across brands. Such data helps the company to make the decision to increase production of strong-selling products or to reduce the inventory of slow-selling products.

This process is complemented by communication between the front line and headquarters, with merchandising frequently adjusted to meet evolving market needs. Tools for facilitating communication between the store sales staff, designers, buyers and merchandisers include a detailed weekly report from each store (this report contains an analysis incorporating a well-defined methodology); meetings held each week, month and season; periodic visits to stores by employees from the headquarters; and teleconferences between store staff and employees from the headquarters.

### **Manufacturing**

UA LTD. outsources the manufacturing function, but has an internal production manager. It has developed a "Manufacturing Platform" management system for selecting factories, planning materials procurement, and controlling manufacturing costs. This platform has enabled the company to integrate information regarding the suppliers and manufacturers handling the various brands, and has also made possible company-level optimization.

### **Logistics**

UA LTD. collaborates with logistics service providers who specialize in apparel to control the supply chain. The company's four logistics centers operate 24 hours a day. At these centers, price tags are put on the products, product quality is monitored, and inventory is managed. The company keeps store inventory at a minimum. Those products having been reported as "sold" that day (up until 11 p.m.) will be delivered to the store before it opens the next day (except in some locations).

### **Store operation and in-store sales activities**

UA LTD. formulates a basic sales policy, which covers all in-store sales activities. The policy defines the cycle of trust-based relationships with customers, customer relationship management, and in-store

merchandising, and specifies the control items and processes involved in store operation.

### **Channel development**

UA LTD. identifies new retail channels with growth potential and opens stores more quickly than its competitors. For example, it was the first among leading select shops to open stores in “Lumine” shopping complexes adjacent to train station buildings and ZOZOTOWN, an online fashion mall, at a time before they had achieved popularity and strong earnings results.

The company is trying to create a seamless shopping experience across real and online stores. Customers can check on product availability at real stores through the company’s online store. Inventory information is updated every ninety minutes, and customers can also access inventory information at real stores. Customers who are unable to decide whether to buy a certain product can get the product number from in-store sales staff. Later on, they can easily locate that product and purchase it through the online store. The company’s online sales, which accounted for 11.2% of total sales in the year ended March 2013, far exceeded the online sales of competitors.

### **Marketing**

UA LTD. is more unique and stronger on advertising activities than its competitors. It relies primarily on TV commercials, train ads, magazine ads, and twitter ads. UA LTD. has won numerous awards for its commercials and advertisements.

### **Human resource management**

UA LTD.’s human resources philosophy centers on the concept of “Creative Merchants,” who are responsible for ensuring the harmonious integration of customer service, business, and creative mindsets. These individuals must also master the complexities of a wide range of fields, while simultaneously cultivating specialized expertise in a single area.

UA LTD. has created the title of “Sales Master” to motivate and develop sales staff. Only a few individuals have been selected as Sales Masters from among 3,000 members of the sales staff after thorough screenings. The company also holds “The Tabaya Grand Prix,” which is a role-playing competition among representatives of the company’s brands. Only one member of the sales staff can represent a brand. This competition serves as a vehicle for sharing the best practices as well as creating a sense of camaraderie.

Tabaya University, the company’s in-house university, provides training programs that place an emphasis on “service, products and environment.” For example, training program participants learn about in-store sales, including measuring techniques, knowledge of quality indicators, and consumer behavior. The in-class learning at Tabaya University is supplemented by in-store training that involves role-playing.

Sales staff members are evaluated using a set of numerical targets that vary according to the role or department. Evaluation criteria include the individual’s total sales performance, the number of customers served, and the purchase conversion ratio. The details that show an individual’s progress are monitored closely. Qualitative information such as thank-you letters from customers are also taken into consideration.

In 2007, UA LTD. granted full-time employee status to all those part-time employees wishing to become full-time employees. (The majority of part-time employees work inside stores.) The company reinforced the thinking among employees that “It’s All About The Customer,” and also increased investment in training for the sales staff.

### **General management**

UA LTD. operates each brand as a business unit. It discontinued ten brands between 2007 and 2009.

UA LTD. works hard to communicate its management philosophy to its employees. It distributes a “Policy Book” to all the employees, and has employees discuss such questions as “For what reason does UA LTD. exist as a company?” “Why do I work?”

## Fit among Activities

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At UA LTD., activities are selected and coordinated in order to realize the company's policy: "It's All About The Customer." The focus of these activities is the development of its "Service, Products and Environment." (Please refer to UNITED ARROWS LTD.'s activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Created "MD (merchandising) Platform" and "Manufacturing Platform" management systems, which enable the efficient management of product development, merchandising, procurement and inventory control.
- Opened stores in new retail channels, such as train station buildings (Lumine) and online fashion malls (ZOZOTOWN), marking a first among select shops.
- Achieved seamless integration of its online store and "brick-and-mortar" stores. Customers can check on product availability at a particular shop through the company's online shop. Customers who are unable to make up their minds about whether to buy an item while visiting a UA LTD. store can request the product number and then order that item from the online store.

## Trade-offs

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- Does not enter the volume segment where lower prices are given higher priority over fashion.
- Does not increase the number of stores faster than personnel can be trained, and does not expand beyond the market size.
- Does not open more new stores in order to sell inventory. Any leftover inventory will be sold at UNITED ARROWS LTD. outlet stores.
- Does not increase sales of original products beyond a certain percentage of the total sales that has been specified for each brand.
- Does not rely on part-time employees for store operation. The company communicates its philosophy and policies to the sales staff at UA LTD stores, and supports sales staff members' skill development through training programs.
- Does not increase stores through franchising. Franchising would reduce the opportunities for direct communication with customers in stores.
- Does not open stores at premises where the rent is higher than the standard rate set by the company. Keeping rent below a certain level is crucial if the company wants to spend more on its sales staff and on the redecoration of stores.
- Does not sell products unless they fit its product development policy: "Trad Mindset." Having "Trad Mindset" entails a deep respect for history and heritage, coupled with an innovative approach, which drives the creation of new traditions.
- Does not have its own factories.
- Does not have its own logistics.

## Consistency of Strategy over Time

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UNITED ARROWS LTD. has been focusing on high fashion and high quality since its foundation in 1989, and has not been operating in market segments that do not fit this focus. Its target customers are “people with a strong interest in fashion, and people who want to enrich life with fashion.” It has been emphasizing “Service, Products and Environment,” and it has been promoting a “Trad Mindset” approach as its product development philosophy.

## Profitability

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Both return on invested capital and return on sales exceed the industry average by a wide margin.

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 17.2%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	5.5%P	9.6%P	19.6%P	24.2%P	28.9%P

Inter quartile range (IQR) = 16.2%P

Return on invested capital = Operating income / Average invested capital

### Return on sales (ROS)

(Unit=percentage point)

Difference from industry average over 5 year period 4.7%P	Difference from industry average, by year				
	2008	2009	2010	2011	2012
	2.1%P	3.1%P	5.5%P	6.0%P	5.4%P

IQR = 7.1%P

Return on sales = Operating income / Net sales

# Activity System Map of UNITED ARROWS LTD.

