

# 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

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# Porter Prize 2015 Winners

Organizing Committee  
Graduate School of International Corporate Strategy, Hitotsubashi University  
2015 Sponsors  
PwC Japan  
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**IBJ, Inc.**

(Marriage-support services)

IBJ, Inc., provides comprehensive marriage-hunting services, ranging from casual activities like matchmaking get-togethers and an online “Kon-Katsu” (marriage-hunting) business to a high-involvement (face-to-face) marriage consulting agency. With the industry’s broadest range of marriage support services and a high customer retention rate (the result of seamless service provided by the company’s various matchmaking services and its marriage consulting agency), IBJ is able to achieve a high marriage rate among its customers.

**Kaneka Corporation, Kanekalon Division**

(Synthetic fibers for hair accessories)

Developed and upgraded the hair accessory product market for women in Africa. Helped to develop more value-added activities at every stage of the industry value chain — encompassing the hair accessory product manufacturers, wholesalers, retailers, and beauty salons — so that they can all benefit from the development of the market.

**Nakagawa Masashichi Shoten Co., Ltd.**

(Manufacturing, wholesale and retail of craft goods)

First company to apply SPA business model to Japan’s traditional crafts industry.

**Shinsei Principal Investments Ltd.**

(Investment bank for small- and medium-sized companies)

An investment bank that focuses on small- and medium-sized enterprises in the Tokyo metropolitan area. Provides financial services that range from venture capital investment to asset restructuring. Services are tailored to meet each SME client’s specific needs, which vary widely depending on the life cycle stage.

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

### IBJ, Inc.

IBJ, Inc., provides comprehensive marriage-hunting services, ranging from casual activities like matchmaking get-togethers and an online “Kon-Katsu” (marriage-hunting) business to a high-involvement (face-to-face) marriage consulting agency. With the industry’s broadest range of marriage support services and a high customer retention rate (the result of seamless service provided by the company’s various matchmaking services and its marriage consulting agency), IBJ is able to achieve a high marriage rate among its customers.<sup>1</sup>

### Executive Summary

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IBJ, Inc. (hereafter, IBJ) brings together single people, supports their marriage hunting efforts through the provision of consulting and other services, and helps them find their way to marriage.

Below are the five services that IBJ provides to single people, to help them meet prospective partners: 1) The company operates an online marriage-hunting website, “Bridal Net” (membership totaled 123,384 at the end of 2014); 2) IBJ hosts casual matchmaking get-togethers and other marriage-hunting events, as well as community gatherings. This includes a service known as “Rush,” which features specially planned matchmaking events, in which groups of single people participate (not individuals); 3) IBJ also offers the “PARTY☆PARTY” service, which involves the hosting of marriage-hunting parties at the company’s own halls. Single individuals participate, not groups (the number of attendees at these events totaled 285,742 in 2014); 4) IBJ also operates “IBJ Members,” a directly managed marriage consulting agency. IBJ Members is recommended for those members who are better prepared for marriage. IBJ Members has achieved a high marriage rate (of a total 3,951 members, 803 couples got married in 2014). Membership for all IBJ’s services combined totaled 320,000 at the end of 2014. IBJ also sells online advertising space to other businesses; 5) Finally, IBJ provides a platform for the numerous independent marriage consulting agencies scattered throughout Japan. This platform is called “Institution Bridal of Japan” (with membership totaling 990 agents at the end of 2014).

A unique feature of IBJ is its provision of a full range of marriage support services. Offerings include everything from casual-style to high-involvement (face-to-face) services, with both online and offline options. In contrast, competitors specialize in either online or offline services, and members must choose between a casual or high-involvement style of service.

Another unique feature of IBJ is its commitment to making marriages happen, and this strong commitment is reflected in each service that the company provides. IBJ works to turn the attendees of the casual get-together parties into regular members and repeat customers by encouraging them to try the company’s more advanced services. Through close contact with attendees, IBJ employees demonstrate their genuine commitment to customer satisfaction. This commitment is further reinforced by IBJ’s policy of making active investments to ensure customer satisfaction and the quality of its services.

IBJ was established in 2000. Annual sales totaled 3.3 billion yen (on a non-consolidated basis) in 2014.

### Unique Value Proposition

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IBJ’s corporate mission is to “Bringing happiness to all the people linked by ‘Go-en’ (fate).” In order to achieve this mission, IBJ aims to “create a national marriage service” (a social infrastructure that single people can use to search for a partner without any hesitation or reservations) and “life design services,” i.e. various services offered to “marriage hunters” as well as services (unrelated to marriage) that propose to the

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<sup>1</sup> The “marriage rate” refers to the proportion of members who exit from the service because they are getting married.

much larger single population ways to enjoy being single.

Because IBJ's goal is to make marriages happen, target customers include not only single people, but also couples already in a relationship. Marriage-hunting activities follow the following steps: an initial meeting, dating, the engagement (an agreement to wed), and marriage (legal or de facto). IBJ provides specific services for each step.

Rush is a service that hosts matchmaking get-togethers and community gatherings. Rush has groups of enrolled members (single people in their twenties to thirties). For these groups, Rush selects a venue from a list of pre-registered restaurants and bars, makes a reservation for the event, and settles the restaurant bill in advance. Prior to the party, services that include how to fill out the profile sheet will be provided by Bridal Net counsellors. Afterward, party facilitators will assist members in obtaining the contact information of other attendees. The party facilitators also contact the event attendees to find out whether they would be interested in getting in touch with anyone they'd met at the venue. This service, which starts with a matchmaking event and ends with the exchange of contact information, is provided in Japan's major cities.

For individual customers who are more serious about marriage, IBJ hosts marriage-hunting parties at its own facilities, and extends support to customers, from the initial meeting stage to the exchange of contact information. IBJ hosts a variety of theme parties. Customers can choose from among the more than fifty different kinds of theme parties (including sports parties) that IBJ offers. Customers enroll online, and only individual reservations are accepted. IBJ stays in contact with the people who have attended the PARTY☆PARTY events, by sending them the company's online magazine or invitations to theme parties that have been specially selected to match their specific interests. Customers can not exchange contact details unless they have mutually agreed to do so at the party, or have made arrangements with party facilitators. Customers are mainly in their twenties to forties. The facilities are located primarily in the major cities of Tokyo, Nagoya, and Osaka. These facilities have private rooms where two people can enjoy a conversation without any distractions. IBJ will only hold a party if an equal number of men and women register for the event. The price for attending a PARTY☆PARTY event is more expensive than those hosted by competitors.

Customers can use Bridal Net anytime, at their convenience, to search for potential candidates, taking into account their own personal interests and ways of thinking. Although this is an online service, experts at IBJ's call centers will provide advice around the clock. These experts include experienced party facilitators and consultants from the marriage consulting agency. The Bridal Net service begins with an online request for an exchange of contact information. After receiving the marriage candidate's consent, contact information is exchanged. Various types of support are provided to customers during the dating process. IBJ ensures the quality of its members by requiring the submission of IDs, and curbs impulsiveness by requiring members to wait 24 hours to receive a reply from a potential candidate after making a request for contact. Customers can conduct searches in "special interest" areas. They can also conduct searches based on lifestyle preferences by clicking on "Minna no Nikki" (lit. Everybody's Diary) or look for an individual who shares an affinity for visiting a specific physical location by clicking on "Minna no Mappu" (lit. Everybody's Map). Some additional services, like seminars, are provided offline. Customers are mostly in their twenties to forties, and come from various parts of Japan.

IBJ Members is marriage consulting agency that is directly managed by IBJ. Customers meet face-to-face with a dedicated consultant, who provides support through all stages of the marriage hunting process: an "Omiai" (arranged meeting), in which the IBJ member has a one-on-one meeting with a single candidate; the exchange of contact information; the commencement of dating; and, finally, the agreement to wed (engagement). Most customers are in their twenties to fifties. The marriage consulting agency operates eight lounges (at the end of 2014), located primarily in the major cities of Tokyo, Nagoya, and Osaka. Each lounge has private rooms, and the facilities are comfortable. The enrollment fee for this service is on par with the industry average, and the monthly fee is about 50% lower than the industry average. The marriage-hunting support fee, however, is much more expensive than the industry average; this higher price reflects the extensive counselling and support that members receive. IBJ asks for a fixed amount as a "completion bonus" when

customers exit IBJ Members to get married.

Institution Bridal of Japan provides an arranged-marriage management system, which helps member agencies to improve their management of personal information. Institution Bridal of Japan provides standardized forms for contracts, holds lectures on compliance, shares know-how and announces the latest news at its regular meetings. Member agencies can refer customers to the other agencies that are members of this network.

## Unique Value Chain

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IBJ's unique value chain consists of the following activities: 1) customer acquisition; 2) the maintenance of membership quality; 3) systems and website development; and 4) human resource management.

### Customer acquisition

Members of any service provided by IBJ set up an account with the company. Therefore, they do not have to register a new profile every time they use a different service. If a customer finds that a particular service does not fit his or her needs, IBJ encourages that person to try the other services offered by IBJ. The company actively informs members about the various services on offer. IBJ has a lower customer acquisition cost than its competitors. For example, people attending one of the PARTY☆PARTY events held at an IBJ Members lounge will have the opportunity to learn about the marriage consulting agency's services.

Upon enrollment, IBJ requires that customers applying for membership submit IDs and other documents to ensure the validity and reliability of the personal information provided. Proof of marital status is required for IBJ Members and Bridal Net, while proof of academic background and income level are required for IBJ Members and recommended for Bridal Net before the commencement of any activities.

### Operations

Any illegal or immoral activities are strictly prohibited, both online and offline. Online communication is monitored systematically, and prompt remedial action will be taken. Such action includes the disposing of information, the sending of warning messages, the immediate ban on participation, and the revoking of membership.

The online service, Bridal Net, also offers offline services, and the operating know-how for marriage-hunting parties is utilized to supplement these offline services. Such offline services include lessons for improving communication and enhancing one's personal appeal.

### Website and system development

By internally conducting system development and website design, IBJ can ensure the appropriate management of personal information and the sharing of the system among the different services. IBJ has the system developers and the planner of each service work closely together, a practice that enables know-how to be systematized and simplifies the manual operation. This also makes customer service more convenient. For example, a group of customers attending a get-together party through Rush needs only to input the date, time and place; the system will automatically select an appropriate group of candidates, and a meeting will be arranged.

### Human Resource Management

IBJ puts a priority on the development of personnel who are skillful coordinators that know how to work closely with individuals to resolve issues of the human heart. The company provides in-house training once every three months. The training program includes lectures from all IBJ executives, a program to increase enrollment, and a program to upgrade marriage consulting skills. Training covers specific topics to improve problem-solving skills. Employees are ranked by their skill level and are encouraged to improve their skills. IBJ expects all employees to contribute to business improvement, and openly shares financial information. Executives explain the company's direction once every six months, and share the management philosophy by

distributing the IBJ handbook and posting columns on the internal portal site.

Managers are chosen from among volunteers, and management candidates have the opportunity twice a year to make a presentation to management.

## Fit among Activities

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IBJ's activities are chosen with the aim of increasing the number of marriages, and activities online and offline are organically connected. What is unique is that both the marriage-hunting parties and the marriage-hunting website recruit members for the services offered by the marriage consulting agency, which has the highest success rate in helping customers get married. Also, it is impressive that know-how is shared among the company's different services. For example, know-how developed by consultants at IBJ Members is applied to Bridal Net's call center service. The operating know-how of IBJ Members is applied to Institution Bridal of Japan. (Please refer to IBJ's activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Japan's first online marriage-hunting website, Bridal Net (launched in 2000). The concept behind the Bridal Net service is to help customers find marriage partners online. To differentiate its site from existing dating websites, Bridal Net required IDs from the very beginning, and specified the observance of a 24-hour "cooling-off" period before contact could be initiated after the matchmaking event.
- The scope of business combining Bridal Net with marriage-hunting parties and a marriage consulting agency (since 2006).
- The introduction of a "completion bonus" for the marriage consulting agency (since 2006).

## Trade-offs

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- Does not focus only on an online or offline business format. Combines the convenience, efficiency, and quality features that are built into the system of an online service with face-to-face consultations by consultants, which are a critical component for helping customers to reach an agreement to wed.
- Does not pursue geographical expansion. Limits offline services to Japan's major cities, so that IBJ can have access to a bigger customer base and high-quality staff members.
- Does not sacrifice the quality of members just to increase the number of members. IBJ raises the hurdle for enrollment by requiring the submission of IDs, which reduces the level of convenience and is contrary to customers' normal expectations regarding online services. IBJ does not set different prices for male and female members.
- Does not pursue efficiency for each service. For example, marriage-hunting parties sacrifice the number of attendees by emphasizing the "quality of the meeting" through the use of lounges that seem like private rooms. By achieving high customer satisfaction (through an emphasis on quality over quantity in the marriage-hunting parties service), more customers stay on as members of the marriage consulting agency, (where emphasis is placed on both quantity and quality).
- Does not rely on advertising to increase enrollment in the agency's services.

## Consistency of Strategy over Time

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Since its launch in 2000, the objective of the Bridal Net online matchmaking service has always been to provide single people the support they need to get married. From the very beginning, Bridal Net has been

learning from the examples offered by conventional offline marriage consulting agencies, and Bridal Net clearly views marriage as the ultimate goal of the service it provides. The idea behind Bridal Net was to create an online service similar to the conventional matchmaking services being offered in Japan, and take full advantage of the higher efficiency afforded by an online system. However, it was necessary to make sure that the customers were really serious about wanting to get married. Bridal Net did its best to create a customer base of suitable candidates, and vetted online applicants by requesting IDs. Bridal Net also enforced a “cooling off” period before sharing a prospective partner’s contact information.

Bridal Net became a wholly owned subsidiary of Yahoo! Japan in 2003 in order to enhance customer acquisition through higher brand recognition and improved website credibility. Soon, the executives of the company realized that in order for customers to reach an agreement to wed, they would first need consultations and advice from professionals. This is what prompted a subsequent management buyout (MBO) from Yahoo! Japan in 2006. Soon, the same executives started a marriage consulting agency service, IBJ Members, and Institution Bridal of Japan. In 2009, IBJ absorbed the operations of Bridal Net, which strengthened integration between the online and offline businesses and created synergies among the company’s different services.

Then, to increase offline opportunities for meeting potential marriage partners, IBJ began hosting get-together parties (Rush) and marriage-hunting parties (PARTY☆PARTY). In 2013, IBJ arranged the takeover of a systems development company to reinforce in-house systems development capabilities.

## Profitability

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Both the five-year average of return on invested capital and return on sales exceed the industry average. (Profitability analysis was conducted by PwC Japan.)

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 12.6%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-63.5%P	-7.4%P	21.9%P	21.1%P	27.3%P

Inter quartile range (IQR) = 9.6%P

Return on invested capital = Operating income / Average invested capital

### Return on sales (ROS)

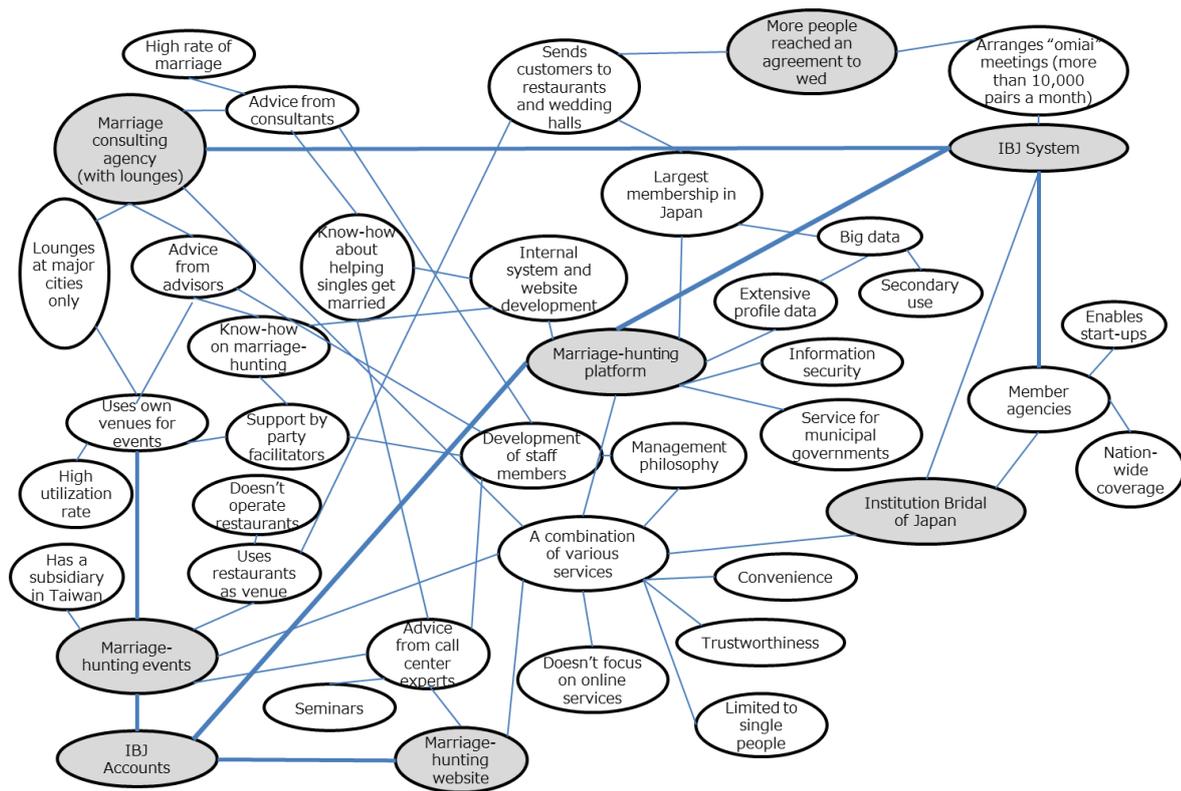
(Unit=percentage point)

Difference from industry average over 5 year period 5.4%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-17.9%P	2.5%P	8.9%P	11.8%P	5.1%P

IQR = 17.6%P

Return on sales = Operating income / Net sales

# Activity System Map of IBJ, Inc.



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

### **Kaneka Corporation, Kanekalon Division**

Developed and upgraded the hair accessory product market for women in Africa. Helped to develop more value-added activities at every stage of the industry value chain — encompassing the hair accessory product manufacturers, wholesalers, retailers, and beauty salons — so that they can all benefit from the development of the market.

#### Executive Summary

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The size of the market for the synthetic fibers used as the materials for hair accessory products (i.e. wigs and hair extensions) is not large, accounting for less than 1% of the total synthetic fiber market (on a volume basis). Kaneka holds a 40% share of the global market, and a 60% share of the African market, a market in which further growth is expected. Hair accessory products are an accessible daily fashion item for African women, whose hair tends not to grow long. This is one reason why the African market is the biggest in the world — accounting for 50% of global demand for hair accessory products in 2014 (according to Kaneka).

Kaneka, a fiber maker, does not produce hair accessory products. However, it did help to develop the market for hair accessory products in Africa by introducing to local beauty shops popular hairstyles from around the world, and by proposing hairstyles to the makers of hair accessory products.

Many Japanese fiber makers entered this market during the fashion wig boom in the 1960s and 1970s. However, once the boom ended, many competitors exited the market, and only two Japanese makers now supply this market. Their current competitors are Korean and Chinese fiber makers. The fibers used in hair accessory products are acrylic, vinyl chloride, polyester and polypropylene, and each material performs differently in terms of heat-resistance, workability, nonflammability and cost.

#### Unique Value Proposition

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Kanekalon Division's philosophy is to “be a fiber business with sustainable growth, achieved through high profitability, and contribute to society by creating culture.” Its mission is to provide “beauty, quality and safety” to women.

Kaneka not only supplies fibers as materials for hair accessory products, it also provides solutions to the industry's value chain, which extends from the fibers to the end-users. Kaneka communicates directly with hair accessory product makers, wholesalers, retailers, and beauty salons to understand their needs and provide support that will add value to their activities.

Kaneka manufactures the largest variety of fibers. The only fibers Kaneka does not supply are human hair and flammable fibers (out of a concern for safety). Kaneka's fibers add a natural look and touch to the fashionable hair accessories. Some of these fibers have unique features. Acrylic Kanekalon, which doesn't get dirty easily and is fast-drying, responds to new demand among the growing number of middle-class women in Africa who have added swimming to their leisure activities. Kaneka has made popular the use of a heat styling iron for hairstyling by providing nonflammable heat-resistant polyester Kanekalon. This material has made it easier for women to change their hairstyles.

For hair accessory makers, Kaneka proposes products based on an understanding of both hairstyles that are popular around the world and local customer needs. Kaneka's proposals include suggestions about using a combination of different kinds of fibers. The company also makes recommendations regarding superior methods for processing and finishing. This has made possible the introduction of new hairstyles to African women.

Kaneka helps the makers of hair accessory products improve the quality control and productivity of their factories, knowing that reliable quality and stable supply can be differentiating factors for consumers. Kaneka helps hair accessory makers conduct process analysis and improve the production environment. The company also helps educate the workers involved in the actual production of hair accessory products in the factory. Some specially selected factory workers (both men and women) have been invited to visit Kaneka's factory in Japan and learn about the fiber materials and quality control. Thanks to these efforts, both quality control and productivity have improved for the makers of hair accessory products, and these local factory workers have been assigned to higher positions.

For beauty salons, Kaneka hosts seminars and teaches hairdressers how to distinguish differences in the quality of hair extensions and other synthetic hair accessory products, and how to create new hairstyles. This helps them to improve their skills. Meanwhile, end-users have started going to beauty salons instead of just asking their family members to attach their hair extensions at home. Since 2010, Kaneka has been organizing the annual Kanekalon Hair Show in Nigeria, in order to encourage hairdressers to improve their skills. This event includes a hairstyle design competition, and local hairdressers must compete and win in their own regional blocks before preceding to the final contest, held in Lagos, Nigeria's largest commercial city.

Kaneka has made a major contribution in helping the African hair accessory products market to become a more upscale market. One example is the braid segment. Polypropylene once dominated this segment with a 70% market share. Indeed, polypropylene is less expensive, at about 50 cents a package, but it is flammable. Taking into consideration that hair extensions and wigs might catch fire when women are cooking, Kaneka does not include flammable materials in its synthetic fiber product line. Instead, Kaneka encourages the use of acrylic Kanekalon for synthetic braid extensions. According to the company, the most appealing feature of acrylic Kanekalon is that it is easier to arrange into hairstyles, involving a simple process. Another merit is that this fiber material does not hurt the hairdressers' finger tips when they are handling it. Moreover, as a more expensive product, it delivers a higher margin to hair accessory product makers, wholesalers, retailers and beauty salons. In the early 2000s, acrylic Kanekalon had a 70% share of the market for synthetic braid extensions.

Kanekalon hair products are more expensive than those of competitors, as illustrated in the case of the braid extensions mentioned above.

## Unique Value Chain

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In order to deliver solutions to the entire industry value chain (through to the end-user), the Kanekalon Division has created a unique value chain that includes marketing, R&D, manufacturing, and human resource management.

### **Marketing**

As a result of holding a large market share, Kaneka has access to macro-level market data (i.e. data on the balance between supply and demand in the global market). However, the company also conducts its own market research at the micro-level, by counting the number of hairstyle variations on the street, for example. Kaneka has a better understanding of the market than hair accessory product makers and beauty salons.

Kaneka has established a track record in creating markets for its products utilizing a "pull" strategy. First, Kaneka helps consumers recognize their need for hair accessory products. Next, consumers ask for Kaneka products at retailers and beauty salons. Finally, retailers and beauty salons convey consumers' requests directly to the makers of hair accessory products. When Kaneka first entered the African market, it introduced to beauticians and consumers various hairstyle and color products that were trending among African Americans in the U.S. Kaneka has successfully differentiated its Kanekalon brand items from existing products by positioning them as high-value-added products. As for weave extensions, Kaneka was a latecomer. In a strategic move, Kaneko created weave extension products that featured new styles and all-new colors that had

become possible by mixing acrylic Kanekalon and vinyl chloride Kanekalon. Kaneka made prototypes of these new products and introduced them to the market. Sure enough, end-users, upon seeing these new products, urged wholesalers to request that hair accessory product makers use Kanekalon materials. Now, vinyl chloride Kanekalon currently enjoys a 50% share of the market in Africa. In order to have greater influence on consumers, Kaneka has organized the annual Kanekalon Hair Show in Lagos, Nigeria, which was first held in 2010. At this event, hairdressers compete and show off their skills using Kanekalon products.

## **R&D**

Kaneka manufactures four kinds of synthetic fibers: acrylic, vinyl chloride, polyester and polypropylene. Kaneka is able to submit product proposals directly to hair accessory makers because it has the broadest product line in the industry, as well as because of the fact that some materials are more appropriate for hair accessory products than others.

In Africa, researchers of Kanekalon fibers visit hair accessory factories and beauty salons, where they speak directly with people in the field, as well as consumers, to learn about their various needs. This feedback is then reflected in the development of fibers.

The Product Development Group is responsible for the next step in product development, which is to evaluate hair accessory prototypes that have been created in-house at the company's own prototyping factory. The Product Development Group evaluates the prototypes in terms of performance and manufacturability (i.e. the feasibility of mass production) for hair accessory makers. Later, working in collaboration with hair accessory makers, the Product Development Group conducts the test marketing of the new hair accessory products. Finally, the fiber development team is given feedback on the results of test marketing.

## **Manufacturing**

Kanekalon fibers are manufactured in Japan, China and Malaysia.

Kaneka maintains a balance between demand and supply throughout the industry value chain in order to prevent a significant shortage of supply, which often happens in a rapidly growing market. A shortage of supply often encourages new entrants or allows competitors to grow their market share. Kaneka forecasts demand based on its analysis, and proposes capacity expansion to hair accessory product makers if it determines that their manufacturing volumes are insufficient. If hair accessory makers have an overcapacity, Kaneka encourages them to export to markets where the supply is insufficient. Kaneka can do this because it has the broadest coverage of the global market.

## **Human Resources Management**

In order to contribute to the industry's entire value chain, Kaneka provides its employees extensive training, and organizes educational programs that cover a variety of topics, including the properties of fibers, foreign language instruction, marketing, and explanations on how to use the machinery that produces hair accessory products. In addition, the company arranges on-the-job training at beauty salons and hair accessory factories. Employees are also given the opportunity to undergo on-the-job training for market research in the field. Kaneka hires people with backgrounds as professional beauticians, and encourages other employees to obtain a beautician license. Sales staff are assigned to the New Product Development Group for at least one month of training, and as part of this training they assemble hair accessory products. Fiber researchers are required to learn the basics of marketing.

Kaneka educates people at the lower end of the industry value chain. Kaneka hosts seminars on product quality and new hairstyles for hairdressers, and organizes hairstyling contests. For the makers of hair accessory products, Kaneka provides lectures on market analysis and quality control. The company also collaborates with hair accessory makers on the test marketing of prototypes. In addition, special selected workers from hair accessory factories are invited to Japan and given instruction regarding the properties of various fibers, quality control and other issues related to production site management. As a result of this training, a factory in Kenya has been able to improve productivity by 24% and reduce the defect rate by 30% in one year. This factory, recognized as being the hair accessory maker's best factory, was made responsible for training workers at

factories in other African countries. Factories in Uganda and Tanzania are especially eager to improve their performance, motivated by the achievements of the factory in Kenya, a neighboring country. Hair accessory makers not only have enjoyed improved profitability, but also have developed a deeper trust in Kaneka, which has contributed to a stable relationship.

## Fit among Activities

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The activities of the Kanekalon Division have been selected to realize 1) the division's philosophy, which is to "be a fiber business with sustainable growth, achieved through high profitability, and contribute to society by creating culture"; and 2) its mission of providing "beauty, quality and safety" to women. The core of its strategy is to be extensively and deeply involved with the industry value chain. Activities to realize this strategy include: 1) The optimization of supply; 2) an emphasis on human resource development; and 3) market-oriented R&D. These activities, which are well matched, form a highly coherent system for realizing the company's strategy. (Please refer to Kaneka Corporation, Kanekalon Division's activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Development of the hair accessory products market in Africa. It was in the early 1980s when Kaneka noticed the African market (Senegal, specifically), a time when many African countries were experiencing turmoil following independence, and competitors were not considering Africa as a potential market.
- Creation of a supply chain that enabled the penetration of the African market. Kaneka encouraged Korean-affiliated hair accessory product makers to open factories in Africa. Until then, hair accessory product makers had been exporting their products to the U.S. from Asia. In addition, Kaneka decided to begin working with Lebanese-affiliated hair accessory makers who had established a wide network in Africa. Hair accessory factories that use Kanekalon fibers are currently operating in 18 countries in Sub-Saharan Africa. In a sense, Kaneka has built the hair accessory product manufacturing industry in Africa.
- The New Product Development Group undertakes the processing of fibers in-house, and can propose new final products. This requires substantial capital investment, but this willingness to invest is pervasive in Kaneka Corporation, and a deeper understanding of customers' products (i.e. the products of hair accessory makers) is considered a critical activity that enables the differentiation of Kaneka's products.

## Trade-offs

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- Does not allow for oversupply in the market for the purpose of securing a higher market share or an increase in sales volumes. In order to maintain the value of its products, it ensures that supply remains tight.
- Does not sell flammable fibers out of consideration for users' safety. Making fibers nonflammable is technologically challenging and means higher costs. Still, Kaneka remains committed to selling only nonflammable fibers.
- Does not go after volume in the low end. Rather, tries to shift the market to the high end.
- Does not increase the number of hair accessory product makers it deals with. The addition of more hair accessory product makers as customers would easily increase sales, but the company makes it a priority to share its business policy with its existing hair accessory makers. Kaneka works in together with these makers to maintain a commitment to quality, and endeavors to grow the market through the proposal of new hairstyles.

## Consistency of Strategy over Time

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The first consistent element in Kaneka's strategy is its commitment to safety. Even when flammable fibers dominated the market, Kaneka refused to sell flammable fibers.

The second element is a market orientation that is based on the understanding that consumers' needs are what drive the industry. A good example is the "pull" strategy (i.e. the strategy of approaching consumers and hairdressers directly) that the company employed when it entered the weave extension segment as a latecomer.

The third element is its commitment to contributing to the industry value chain and creating a win-win situation. Kaneka contributed to the enhancement of capabilities of its carefully selected business partners, who share the same values and competitive strategy. By cooperating with its partners, the company has expanded the market and enabled players to enjoy growth, high profitability, and the creation of employment.

The fourth element is its commitment to achieving high profitability through differentiated products (and avoiding price competition), as evidenced by the upscale shift in the market for braid products.

## Profitability

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Both the five-year average return on invested capital and return on sales exceed the industry average by a wide margin. (Profitability analysis was conducted by PwC Japan.)

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 14.5%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-2.3%P	0.6%P	10.8%P	23.9%P	32.3%P

Inter quartile range (IQR) = 3.0%P

Return on invested capital = Operating income / Average invested capital

### Return on sales (ROS)

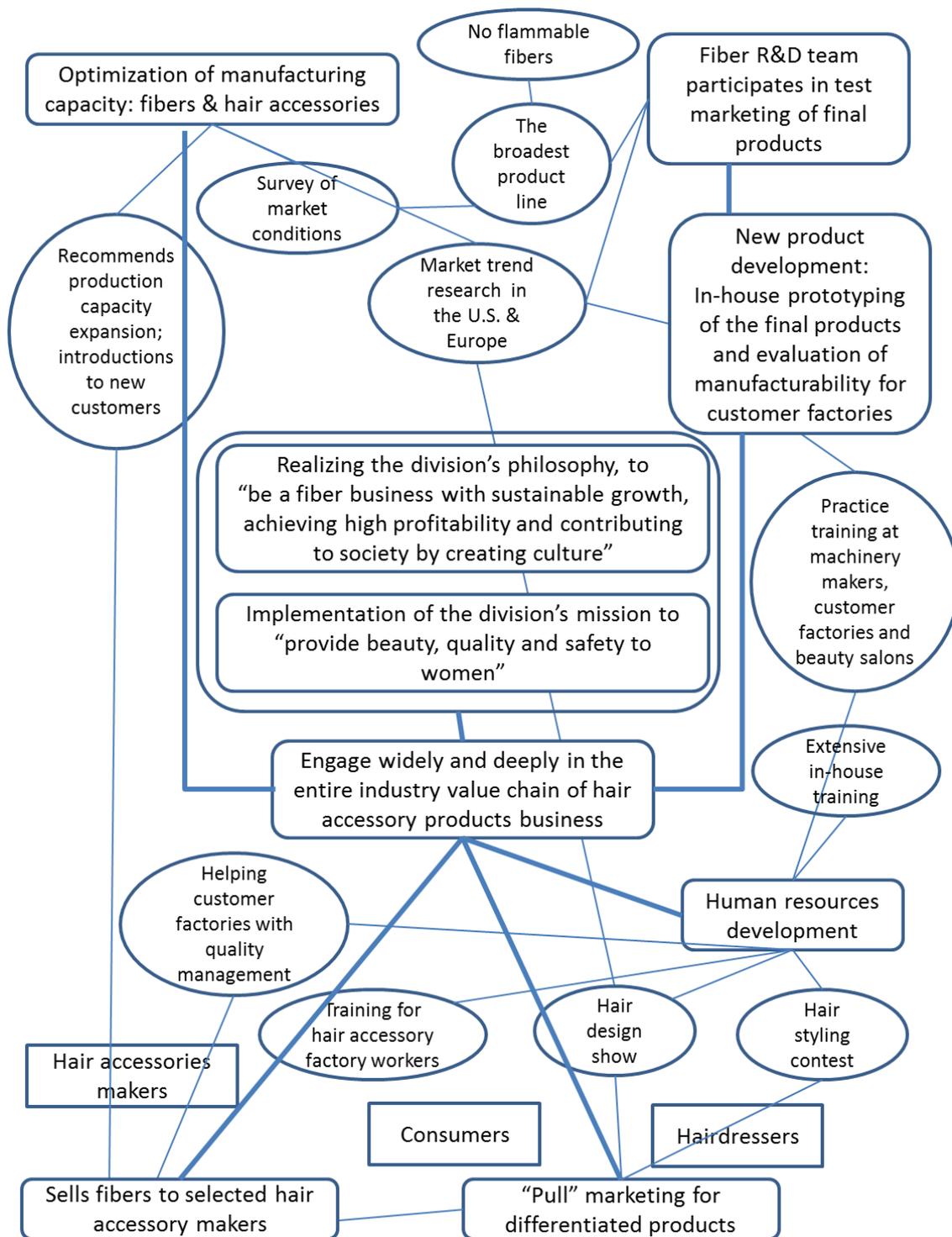
(Unit=percentage point)

Difference from industry average over 5 year period 8.3%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-2.3%P	-1.2%P	6.8%P	13.0%P	20.1%P

IQR = 4.1%P

Return on sales = Operating income / Net sales

# Activity System Map of Kaneka Corporation, Kanekalon Division



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

### **Nakagawa Masashichi Shoten Co., Ltd.**

First company to apply SPA business model to Japan's traditional crafts industry.

#### Executive Summary

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Nakagawa Masashichi Shoten Co., Ltd. was the first company to apply the SPA (specialty store retailer of private label apparel) business model to the industry for traditional Japanese crafts. The company's directly operated retail shops specialize in household items that feature Japanese craftwork. The company produces mainly cloth products, centered on its traditional business of manufacturing hemp cloth.

It has retail shops under three main brands, and directly operates all 43 shops. Yu Nakagawa specializes in textile products that combine traditional materials, skills and designs with a contemporary feel (16 shops as of February 2015). Nakagawa Masashichi Shoten carries many functional and beautiful "tools for living" rooted in the home and daily life (21 shops). Nipponichi offers crafts from various parts of Japan, as well as products that incorporate the motifs of local Japanese souvenir craft items (6 shops).

Nakagawa Masashichi Shoten's vision is to "revitalize Japanese crafts." For the company, "revitalization" means that craft makers and their local production bases can become financially independent (i.e. no longer having to rely on subsidies), and feel renewed pride in Japanese monozukuri (workmanship in manufacturing). To realize this vision, the company provides consulting services to craft makers, helping them to improve their management and planning. This ultimately leads to a broader selection of merchandise at the company's shops. The company is also contributing to the revitalization of a "travel souvenirs market" for crafts, by making local crafts available to local souvenir shops. This makes it possible for locally produced crafts to be consumed locally.

In 1990, the craft industry in Japan had 26,000 companies, with a volume of production valued at 500 billion yen. In 2005, the industry had shrunk to 13,000 companies, with a volume of production valued at 190 billion yen.

Nakagawa Masashichi Shoten was founded in 1716 in Nara (incorporated in 1983). The company, with 305 employees, reported annual sales of 4.3 billion yen in the fiscal year ended in February 2015. The following is the company's composition of sales: retail shops (70%), wholesale (20%), and online sales (10%).

#### Unique Value Proposition

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The stores the company operates carry mainly household goods that feature traditional Japanese crafts, i.e., crafts that are made using traditional skills and designs. Although these items have a traditional charm, they also fit in well with a contemporary lifestyle. The company's best-selling Hanafukin (dishcloth) is made of the sheer cotton fabric used in mosquito nets. Another best seller is porcelain mugs, produced in the town of Hasami (Nagasaki Prefecture). Customers enjoy the various nuances of the carefully crafted pieces, which are long-lasting and have a subtle charm that grows over time with continued use. Shop staff members who are knowledgeable about the products provide customers with extensive background information and other details. Customers also enjoy learning about the history of the local craft community, the uniqueness of the techniques used, and the corporate vision of Nakagawa Masashichi Shoten to "Revitalize Japanese crafts." There are not many retail shop-chains that carry only Japanese crafts. The merchandise carried at the company's shops are much lower priced than the expensive craft pieces sold at department stores. The company's target customers are female shoppers of all ages.

The company's other target customers are the craft makers themselves. In order to realize its vision of revitalizing Japanese crafts, the company provides consulting services to craft makers, advising them on ways

to improve management, conduct manufacturing with more of a mind for business, and implement operational reforms. Because Nakagawa Masashichi Shoten aims to help craft makers achieve independence, the company does not guarantee that it will purchase crafts from these consulting clients. However, it does provide a sales channel by inviting craft makers to take part in a crafts exhibition that the company organizes, an event called Dainipponichi. (This event is important because it is attended by distributors.) If the company's brand managers give their approval, Nakagawa Masashichi Shoten will agree to carry a craft maker's products in its stores, thus providing a retail outlet. It will also undertake long-term consulting services (for a duration of one to two years on average). The consulting services, therefore, are not just a one-time shot at helping a craft maker with product development. The success of craft makers the company has advised generates a ripple effect that triggers a kind of chain reaction among other companies within the region. The company had its first big success with Maruhiro, a leading producer of Hasami ceramics (including porcelain and pottery), based in the town of Hasami, in Nagasaki Prefecture, an area that has a 300-year history of ceramic tableware production and wholesale. Other craft makers that were inspired by this success story have since become No.2 and No.3 in the same area. Meanwhile, Maruhiro has begun collaborating with the producers of Arita porcelain, located in the town of Arita, in Saga Prefecture. (Arita is one of the largest porcelain-producing centers in Japan today.) Through this move, Maruhiro's impact has extended beyond its local craft community in Nagasaki prefecture to the neighboring prefecture of Saga. The consulting fee that Nakagawa Masashichi Shoten charges is not expensive, but the company receives a margin on retail sales if the products are sold at one or more of its stores, and also gets paid a distribution support fee by crafts makers on orders received at the Dainipponichi event.

The third group of customers are local souvenir shops and the tourists that visit these shops. The company undertakes product planning, and asks local craft makers to produce the products that have been developed. Nakagawa Masashichi Shoten then purchases all the finished products, and advises souvenir shops on how to sell these products. (The company calls participating souvenir shops "nakamamise" -- lit. collaborating shops.) This enables local craft makers to minimize their inventory risk. The other benefit for craft makers is that they can see their products being sold at local stores. This helps the craft makers to take pride in their craft and contributes to a wider appreciation for monozukuri (workmanship in manufacturing). Souvenir shops can enjoy growth and improved profitability by selling more value-added products, while instilling renewed pride in local crafts. The company charges the souvenir shops a consulting fee. In return, souvenir shops are able to see sales stabilize over the long term. Currently 80% of the travel souvenir market is made up of food products, while 20% consists of other merchandise. For many years, food products and other merchandise had each accounted for 50% of the market. The size of the travel souvenir market is estimated to be 3.5 trillion yen.

## Unique Value Chain

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As an SPA, Nakagawa Masashichi Shoten's value chain can be viewed as separate but connected value chains for manufacturing, wholesaling, retailing and consulting. In addition, there are functions shared by all these value chains. Rather than provide an exhaustive list, below we will focus only on the unique features.

### **Business planning and system development**

#### **Manufacturing**

The company employs craft-based manufacturing, which requires both a degree of a skill and extra care, with production conducted in small- or medium-size batches. (The company does not undertake mass production.) This is because the company puts an emphasis on the subtle texture of its cloth products. The Hanafukin (lit. flower dishcloth), the company's long-seller, is woven using a traditional shuttle loom, and the operation of this loom requires delicate adjustments. Sewing is done on a sewing machine, one piece at a time. This is the secret to the product's long-lasting, high-quality finish.

### **Sales of in-house manufactured products**

The company organizes the Dainipponichi event three times a year. The company's network of distributors attends this event and place orders. This event is a major sales channel for the company, along with the shops that it directly manages. The company also encourages craft makers for whom it has provided consulting services to participate in this event. The event affords these craft makers a specialized sales route, and this unique service is only available through Nakagawa Masashichi Shoten.

### **Merchandising for the retail shops**

The merchandise sold at Nakagawa Masashichi Shoten's retail shops consist of: 1) the products made by craft makers for whom the company has provided consulting; and 2) the souvenir products for which the company has undertaken planning. (Production of these souvenir products is consigned on an OEM basis.) In recent years, the number of craft makers has been decreasing rapidly due to the aging of workers and the contraction of the market. For a company that operates retail shops specializing in craft-based household goods, it is critical to ensure a stable supply of products.

### **Firm infrastructure of retail operations**

The company assigns a designated brand manager to each store (Yu Nakagawa, Nakagawa Masashichi Shoten, and Nipponichi). Brand managers are in charge of product planning, store operation, and management.

### **Sales and marketing**

At the stores, sales staff explain to customers the company's vision, communicating Nakagawa Masashichi Shoten's commitment to craft-based monozukuri (workmanship in manufacturing), and sharing information regarding the background of each product.

The company does not advertise. It does, however, make extensive use of publicity. The company's unique vision, activities and performance have attracted much media attention, and the company has benefitted from extensive media coverage. In addition, the president, Jun Nakagawa, has brought attention to the company by publishing books on the company's turnaround story and his theory of brand management. Another reason that the company enjoys so much exposure is the fact that its directly operated retail shops (43 shops in total) are located at high-traffic spots inside commercial retail facilities. Their prime location helps to raise brand awareness among consumers.

### **R&D**

The company is able to articulate its product planning know-how, and has developed this know-how into a system that can be taught. This systematized approach minimizes the variability of the content when consulting services are provided by different people, and improves the overall performance of the company.

### **Human resources management**

The salary level at the company is not as high as the salaries offered by leading retail companies, but Nakagawa Masashichi Shoten can attract employees who share its vision: "Revitalize Japanese crafts." Participation in consulting services is considered to be part of employees' training.

## **Fit among Activities**

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Nakagawa Masashichi Shoten's activities are chosen to realize its vision, "Revitalize Japanese crafts." The activities can be categorized primarily in three groups.

The first group focuses on monozukuri (workmanship in manufacturing). Consulting services and the Nipponichi Project belong to this group. The second group is centered on distribution, and includes the directly managed retail shops and the Dainipponichi event. The third group concerns human resource development, which supports all the company's activities.

All of these activities have a good fit as a system. The Nipponichi Project improves the financial situation of local craft makers by leveraging their craft skills, but requires Nakagawa Masashichi Shoten's

involvement in product planning, and the company is responsible for bearing the inventory risk. The products manufactured by the craft makers for whom Nakagawa Masashichi Shoten undertakes consulting will be included in the merchandise handled by the company's shops, and will contribute to the company's overall competitiveness. The shops that the company operates and the Dainipponichi event provide distribution routes to the craft makers for whom the company undertakes consulting. The majority of sales at the stores operated by the company come from the products that Nakagawa Masashichi Shoten manufactures itself. Consequently, the retail business enjoys higher profitability than the shops that rely on purchased goods. (Please refer to Nakagawa Masashichi Shoten Co., Ltd.'s activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Creation of select shops that specialize in craft-based household goods, with an emphasis on quality and design.
- Creation of a platform that helps craft makers to become self-reliant and supports their growth.
- A project to strengthen the position of crafts in the market for travel souvenirs (The Nipponichi Project).

## Trade-offs

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Trade-offs made to revitalize Japanese crafts

- Does not develop a sales channel if that channel comes with unfavorable terms.
- Does not sell products on consignment. The company carries the inventory risk.
- Does not try to buy from craft makers at a price below the product's value. Does not ask for a limited design (to be featured in the company's retail shops) without paying for a design fee.
- Does not mass-produce craft items. Does not automate the production process for the sake of achieving larger production volumes. Does maintain a commitment to quality, willingly spending time and effort for ensuring quality, and limiting production to a small- or medium-sized batches is a priority.

Trade-off for protecting the uniqueness of craft makers

- Does not seek to develop nationwide sales channels for craft-based products that can be produced only in small batches. Preserves the craft's local charm.
- Does not invest in the craft makers for whom the company provides consulting services.
- Does not support craft makers in ways that have only a short-term impact. Aims to help craft makers become self-reliant.
- Does not make craft makers conform to the company's taste and preferences.

Trade-offs for maintaining a unique positioning in the household goods retail industry.

- Does not overly rely on purchased products that the company does not manufacture itself. Purchased products have a shorter lead time and can be put in stores within three months after orders have been placed. However, an over-reliance on purchased products could make the shops too similar in terms of the merchandise carried. For the products that the company manufactures itself, the time required takes nine months from planning to manufacturing. The longer the lead time for planning, the more risks involved. Such risks include unexpected changes in the weather and changes in the external business environment.
- Does not narrow down the items to be sold in the shops. It is not easy to achieve such a broad product line without relying on purchased merchandise.

- Does not carry Western-style craft-based household goods. There is a larger market for such products, but the competition would also be more intense.

## Consistency of Strategy over Time

Nakagawa Masashichi Shoten's strategy began when Jun Nakagawa, the current president, joined the company in 2002 and started to change the company from a manufacturing wholesaler to a manufacturing retailer (SPA). Jun Nakagawa says it was a change "from selling goods to selling a brand." This strategy had two core components: 1) the establishment and development of the original brand; and 2) the operation of retail stores (only Yu Nakagawa stores in 2002).

In 2007, the company articulated its vision with the slogan "Revitalize Japanese crafts," and in 2008, Jun Nakagawa was appointed as the thirteenth president of the company. In 2009, the company started providing consulting services to the makers of Japanese crafts. In June 2010, the first successful client project of the consulting service emerged: the "HASAMI" brand, created by Maruhiro, a producer of Hasami porcelain based in the town of Hasami, Nagasaki Prefecture.

In 2013, the company launched the Nipponichi Project, which revitalizes local craft makers and local travel souvenir shops through the local consumption (sales) of travel souvenirs.

## Profitability

The five-year average return on sales exceeds the industry average by a wide margin. Note that the variability of ROS in this industry is extremely small. The interquartile range (the difference between the upper and lower quartiles) was 0.7 percent point. The group used for comparison is made up of listed companies involved in one or more of the following activities: the manufacturing, wholesale, and retail of household goods. (Profitability analysis was conducted by PwC Japan.)

According to a survey conducted by the Ministry of Economy, Trade and Industry, the average return on sales of retailers of textiles, clothing, and household goods was 4.6% in 2014, while this figure for wholesalers of similar items (clothing and household goods) was 3.3%. Nakagawa Masashich Shoten's return on sales was 8.5% in 2014.

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period -2.6%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-15.4%P	-1.2%P	-1.1%P	-2.6%P	2.4%P

Inter quartile range (IQR) = 9.3%P

Return on invested capital = Operating income / Average invested capital

### Return on sales (ROS)

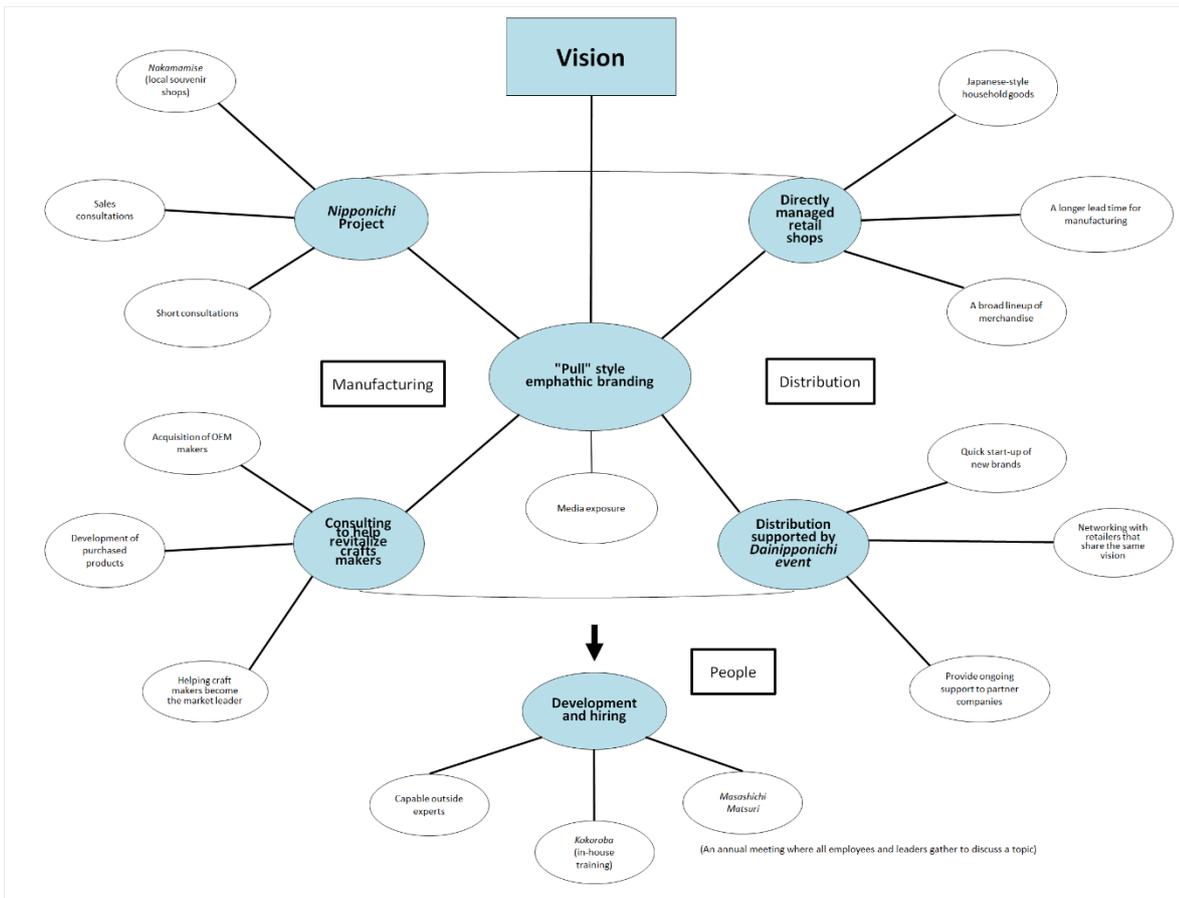
(Unit=percentage point)

Difference from industry average over 5 year period 0.8%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	-3.2%P	1.8%P	0.9%P	2.2%P	0.8%P

IQR = 0.7%P

Return on sales = Operating income / Net sales

# Activity System Map of Nakagawa Masashichi Shoten Co., Ltd.



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

### Shinsei Principal Investments Ltd.

An investment bank that focuses on small- and medium-sized enterprises in the Tokyo metropolitan area. Provides financial services that range from venture capital investment to asset restructuring. Services are tailored to meet each SME client's specific needs, which vary widely depending on the life cycle stage.

### Executive Summary

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Shinsei Principal Investments Ltd. (hereafter, Shinsei PI Group) is a wholly owned subsidiary of Shinsei Bank, Limited (a licensed bank listed on the Tokyo Stock Exchange). Shinsei PI Group targets small- and medium-sized enterprises (hereafter, SMEs) with annual sales of 1 billion to 5 billion yen in the Tokyo metropolitan area. This decision to target Tokyo-based SMEs as the main customer is a unique strategy, one that distinguishes this investment bank from western investment banks, funds and megabanks.

Shinsei PI Group offers a broad selection of services, and its time frame is longer than the usual investment time frames. Its services include private equity investment for start-up companies, financial support when the ownership of a company changes hands, and the purchase of receivables from companies that need restructuring.

Shinsei PI Group has a unique activity system that has resulted in superior performance. SMEs' need for specialized financial services is not new. Financial solutions tailored to the needs of SMEs have been provided in the financial services industry for many years. The financial techniques that Shinsei PI Group provides are not unique. The difference is that Shinsei PI Group has created an activity system that precisely fits the servicing requirements of SMEs. This is how Shinsei PI Group has been able to substantially improve its performance.

Shinsei Principal Investments Ltd. has three wholly owned subsidiaries: 1) Shinsei Corporate Investment Limited, which undertakes private equity investment, including venture capital investment, and buyout investment primarily for business succession (originally, the Private Equity Division of Shinsei Bank); 2) Shinsei Investment & Finance Limited, which purchases receivables and specializes in bridge finance and asset-backed finance. (This company inherited the monetary claims purchasing function of Shinsei Bank's Credit Trading Division, and the lending function of Shinseigin Finance Co., Ltd.); and 3) Shinsei Servicing & Consulting Limited, a licensed servicer that provides support for business turnarounds and business withdrawal, and undertakes the special servicing of real estate-backed commercial loans (originally, the Shinsei Servicing Company).

Shinsei Principal Investments Ltd., which functions as a holding company, executes a variety of administrative duties involved in the provision of financial services, and manages general affairs functions (i.e. compliance, human resource management, accounting and general affairs). These four companies, as a group, are called the "Shinsei PI Group," and the group's slogan is: "Beyond Finance - You can expect more from financial services."

### Unique Value Proposition

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The services provided by Shinsei PI Group include: 1) equity investment (predominantly private equity) for SMEs from start-up to the growth stage; 2) pre-IPO investment; 3) investment in monetary claims (such as loans held by financial institutions) and the purchase of accounts receivables from mature SMEs, to help improve their balance sheets and provide cash; 4) investments for buyouts (a service that makes business succession a smoother process by enabling the ownership of more than half of the voting rights and improving

business performance) and bridge financing to make the succession of business ownership a smoother process.

The target customers of Shinsei PI Group are SMEs based in the Tokyo metropolitan area, with annual sales of 1 billion to 5 billion yen. To be more specific, the target customers for equity investment are SMEs with annual sales of 2 billion to 10 billion yen, and total assets of 2 billion to 5 billion yen; for the purchase of monetary claims, the target customers are SMEs with annual sales of 2 billion yen, a total debt of 10 billion yen, and original loans of 5 billion yen. Companies of this size tend to have diverse needs and require much hand-holding. However, due to the small size of their business transactions (on a value basis), Western investment banks will not usually offer their services to SMEs, and Japanese megabanks do not consider SMEs to be a main customer.

Shinsei PI Group adopts a longer time frame than its competitors. For equity investment, the standard time frame is three years; and for the purchase of monetary claims, five years. Although a longer investment period means a lower internal rate of return (IRR), issues involving SMEs tend to require longer time frames. Also, a flexible time frame provides Shinsei PI Group and the SMEs with options in determining how to exit, taking into account the client company's internal and external environment. In contrast, private equity funds that collect capital from others determine the fund's duration at the time that the fund is formed. Consequently, there is less flexibility with regard to the length of the investment period. Despite the use of longer time frames for its services, Shinsei PI Group assigns one team to the project, and makes that team fully responsible for providing services for the duration of the investment term. This way, the assigned teams, being held responsible for the results, tend to adopt a more disciplined investment approach.

Owners of SMEs have diverse needs. The owners all have different priorities, and their diverse needs include the protection of current employment levels, and the demonstration of appropriate consideration for long-time suppliers and customers. Some owners may want to keep the company name, or preserve certain technologies and craft skills. Others might want their son or daughter to succeed the company, and keep land that has been inherited. Considering that the performance of an SME is highly dependent on the owner, Shinsei PI Group makes the owner's needs its priority, and creates customized solutions. When Shinsei PI Group provides hands-on support, it sometimes assigns employees to temporarily work on-site with employees at the client company, and participate in the client company's in-house training sessions to experience first-hand the learning process involved.

Out of the 60 companies to which Shinsei PI Group has provided pre-IPO financing, more than 20 companies were already listed or were going to be listed within a year. The success rate is more than 30%. (For those companies that are already listed, the success rate also exceeded 30%. The industry average would be about 10%.) More than 90% of client companies for whom Shinsei PI Group purchased monetary claims from other financial institutions saw an improvement in their creditworthiness and a return to "normal debtor" status. The number of companies that filed for bankruptcy was quite low.

## Unique Value Chain

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### **Fundraising**

Shinsei PI Group conducts principal investments through its own accounts because it enjoys a stable funding source in its parent company, Shinsei Bank. It does not have to raise funds in the capital markets, and can be flexible in terms of its investment strategy.

### **Customer acquisition**

There are three routes by which Shinsei PI Group finds and acquires customers. The first route is a "network approach," consisting of personal introductions from the lawyers and tax accountants that serve SMEs. Introductions also come from start-up companies that went public after receiving an investment from Shinsei PI Group. The second route is a "targeted approach," (i.e. a proactive search). Shinsei PI Group lists potential customers, taking into account economic trends, stock prices, foreign exchange rates, public policies,

and changes in regulations and the tax system. Shinsei PI Group sales staff then visit potential customers to gain an understanding of their needs. The third route is one in which customers approach the group directly. Shinsei PI Group has established a very favorable reputation among start-up companies that have a high likelihood of going public. Among these companies, it is said that, “after Shinsei PI Group has made an investment, the other venture capitalists will likely join in.”

### **Investment decision**

Shinsei PI Group conducts thorough quantitative analysis, utilizing indexes, matrixes, and scoring, prior to making the decision to invest. However, what is unique to Shinsei PI Group is its emphasis on qualitative analysis. Through numerous meetings with owners and employees, involving thorough discussions, Shinsei PI Group identifies the client’s key issues and specific needs, and highlights the owner’s typical concerns. For example, is it employment? Or maybe the company’s impact on its business partners?

Quantitative analysis is supported by a wealth of data that is proprietary to the company. Shinsei PI Group has developed a database that includes both client projects in which it has invested, and others in which it has not invested. Staff members can access this database only if necessary. With regard to equity investment, Shinsei PI Group, utilizing its vast collection of data, has studied in depth the cases of 150 companies (out of 3,000 candidates), and has made the decision to invest in 60 companies. Shinsei PI Group’s investment strategy is selective, and priority is given to quality over quantity.

Shinsei PI Group internally conducts real estate evaluations and servicing, rather than outsourcing this function. This allows the company to conduct in-house all the steps necessary for due diligence.

### **Creation of solutions**

Shinsei PI Group develops customized solutions tailored to the needs of individual companies, to identify and address all foreseeable risks. By having the owner understand all possible scenarios, Shinsei PI Group can move quickly and gain the owner’s consent promptly whenever unexpected risks emerge. In this way, Shinsei PI Group is able to achieve a return on investment even amid an unfavorable external environment.

### **Maximizing the value of investments and credit**

Through the cultivation of a close relationship with its customers, Shinsei PI Group can provide advice on governance, compliance, and ways to strengthen the financial base. Shinsei PI Group respects the customer’s autonomy, and is careful not to damage top management’s motivation and sense of ownership. It provides support in the style of a fellow traveler, someone who shares the journey, and who works together with the customer.

In loan servicing, Shinsei PI Group tries to maximize the value of the credit it has purchased by managing the credit properly, while at the same time it tries to help customers recover “normal debtor” status. Shinsei PI Group spends 70% of operating hours on meetings with customers.

### **Portfolio management**

In equity investment, Shinsei PI Group chooses customers in a wide variety of industries in order to diversify risk. In credit purchasing, Shinsei PI Group controls the balance between capital gain through lump-sum repayment and income gain through consistent cash flow repayment by postponing lump-sum payment when the real estate market or financial markets are not favorable. Therefore, even when the external environment is unfavorable, Shinsei PI Group is able to maintain profitability.

### **Human resources management**

At Shinsei PI Group, the same team remains in charge of the same customer for the duration of the project, which usually lasts for a period of three to five years. It is for this reason that Shinsei PI Group does not rotate its employees. One drawback of this approach is that it does not allow the company to rely on a few outstanding performers who might have focused their efforts on the early part of numerous projects. Consequently, Shinsei PI Group must cultivate a large staff of capable employees.

All the staff members at Shinsei PI Group were transferred permanently from Shinsei Bank when

Shinsei Principal Investment Ltd. was incorporated. No members of Shinsei PI Group's staff are on loan from Shinsei Bank.

All hiring is conducted by Shinsei PI Group independently of Shinsei Bank. In hiring, the company looks for individuals who share common values, and who understand the importance of teamwork. For example, any person recognized as not sharing these values (i.e. unable to be a team player) would not be considered as a candidate, despite having superior skills.

Performance evaluations encourage the optimization of the entire group by allocating 70% of the employee's performance grade to the task at hand, and 30% to the contribution that individual makes to the entire group. The evaluation of task performance also encourages teamwork by giving more weight to team performance than to individual performance.

Shinsei PI Group has created only three layers of management, and people in the middle layer are also given the authority to take initiative. In this way, one's position does not prevent a person from taking a leadership role. Leaders are chosen based on the fit with a particular case (client project), and throughout the duration of that project, different members of the team take leadership.

The following is the composition of the company's staff: senior staff, 10%; mid-level staff, 80%; and junior staff, 10%. Mid-level staff members who are above the age of 55 are expected to contribute to development of the other staff members.

The team in charge of a project is responsible for developing solutions for a particular customer, and these solutions must be approved by the top management of Shinsei PI Group. This shorter reporting line to the top management enables top management to monitor the team's performance, especially with regard to the status of the customer relationship, and whether the project is being handled effectively.

Employees can take up to one year of paid leave as sick leave or time off to take care of children or other family members who require special attention.

The average tenure for employees is more than ten years (the company has been in operation for only 14 years). The five-year average employee turnover rate is 4.2%, which is lower than the industry average.

### **Firm infrastructure**

Shinsei Principal Investments and its three 100% subsidiaries are all required to independently manage risk and sensitive information. At the same time, staff members belonging to the different companies are required to work together to develop solutions and offer a combination of services. In order to encourage teamwork among the companies while ensuring that management is being properly conducted, Shinsei PI Group has created an office space that uses glass walls to separate the four companies, which are all located on the same floor. In addition, there are no pillars that might block visibility. Common spaces (such as hallways, the cafeteria, and meeting spaces) are situated outside of the glass walls, and these common spaces are used extensively for communication and collaboration among staff members of the four companies.

The slogans that express the values shared by group members are: "Think about solutions from the customer's perspective," "Draw out the customer's latent potential," "Practice disciplined investment with a long-term perspective."

### **Fit among Activities**

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In Shinsei PI Group, activities are selected and coordinated in order to support the growth, revitalization, and smooth succession of SMEs in the Tokyo metropolitan area by drawing out each company's latent potential through customized solutions that have been carefully developed. The core activities are: 1) "Funding through its own accounts"; 2) "human resource management" that enables the development of specialists; 3) the sharing of know-how; 4) collaboration outside one's area of expertise; and 5) knowledge management that "nurtures

tacit knowledge” and “drives the organization to try something new.” (Please refer to Shinsei Principal Investments Ltd.’s activity system map, which appears at the end of this report.)

## Innovation that Enabled Strategy

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- Flat organization. Shinsei PI Group has only three layers of management. Performance is rewarded through remuneration, not by promotion.

## Trade-offs

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- Does not provide ready-made financial services. Focuses on the provision of order-made financial services that are customized to precisely meet each customer’s specific needs.
- Does not take on more client projects than can be properly handled. The total number of client projects is controlled, so that there will be adequate time to spend with existing clients.
- Does not make investment decisions based only on quantitative factors. Puts an emphasis on qualitative factors to gain a thorough understanding of customers.
- Does not cross-sell financial products or services from outside the scope of investment banking activities.
- Does not compete on price. Does not select client projects in which the critical factor is price or the interest rate. Focuses on client projects that will allow Shinsei PI Group to add value by engaging in face-to-face communication with representatives of the client company and by working closely with the company’s employees.
- Does not make short-term profitability its unequivocal focus. Does ask itself whether Shinsei PI Group is trying to maximize its own profits to the detriment of the customer’s best interests. With regard to loan servicing, Shinsei PI Group prioritizes helping customers improve their repayment capabilities and their business performance over making efforts to sell off the collateral.
- Does not change its priority of supporting SMEs when economic conditions suddenly worsen. Shinsei takes a long-term perspective, and understands that economic conditions, being cyclical, are bound to worsen. It remains committed to helping customers ride out the economic downturn, and instead works to draw out the SME’s latent potential, which cannot be recognized just by looking at numbers. Solutions are found through a process that entails frequent face-to-face communication with representatives of the client company.
- Does not increase the number of branches. (The group operates in one location only.) Makes its priority the development of a strong corporate culture, and ensures that skills are shared among employees.
- Does not seek to increase the scale of business operations. Keeps the size of the organization small enough to make possible the sharing of tacit knowledge, which is critical for maintaining service quality.
- Does not accept employees who are on loan or parachuted in from its parent company, Shinsei Bank. Does not conduct a rotation of personnel with Shinsei Bank.
- Does not rotate personnel within Shinsei PI Group. Develops specialists who can collaborate with colleagues that have different specialties.
- Does not force employees to compete for higher positions by creating numerous layers and having a pyramid-shaped organization, which results in fewer positions at the higher levels. Shinsei PI Group finds that intense competition makes employees less inclined to share their knowledge, contribute to the development of others, and collaborate with others.
- Does not encourage the standardization of operations. Tries to create customized solutions.

## Consistency of Strategy over Time

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Shinsei PI Group has consistently targeted SMEs in the Tokyo metropolitan area. Its lineup of services, meanwhile, has been gradually expanded to meet customers' specific needs. Shinsei PI Group has shown consistency with regard to maintaining a long-term investment policy, encouraging the customization of solutions centered on the needs of the SME owner, and a hands-on approach.

Shinsei Bank's Principal Transactions Sub-Group, which later became the core of Shinsei PI Group, was created in 2001. The group started out as a servicer, purchasing the monetary claims of bankrupt companies (or near-bankrupt companies) from the original creditors—other banks responsible for the disposal of the non-performing loans. (The group would receive repayment from the company after helping it to improve its business performance.) These loans, classified as “bad” loans, were sold at a steep discount. If the division could receive repayment, it would be able to make a profit.

The group started to purchase slightly better loans (i.e. loans to companies that could be restructured). Through the provision of consulting services, the group succeeded in improving the borrower's cash flow and increasing the amount of the repayment. In the process, the group accumulated extensive consulting know-how related to SMEs. Since 2005, the group has been calling on SMEs directly, which is contrary to the standard industry practice at the time, which was to leave the sale of loan credit to the sellers of the credit, i.e., financial institutions. In 2009, the group began providing financial services to SMEs that had sound assets but low credit ratings. In 2011, the group expanded its services to include venture capital investment and buyout investment.

## Profitability

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Both the return on invested capital and the return on sales exceed the industry average by a wide margin. (Profitability analysis was conducted by PwC Japan.)

### Return on invested capital (ROIC)

(Unit=percentage point)

Difference from industry average over 5 year period 4.3%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	1.9%P	1.8%P	3.3%P	4.9%P	13.0%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 54.6%P	Difference from industry average, by year				
	2010	2011	2012	2013	2014
	51.2%P	43.3%P	49.9%P	42.9%P	55.0%P

IQR = 4.8%P

Return on sales = Operating income / Net sales

# Activity System Map of Shinsei Principal Investments Ltd.

