

Porter Prize

Winners Selection Rationale

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.

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Porter Prize 2018 Winners

Organizing Committee

Graduate School of International Corporate Strategy, Hitotsubashi University

2018 Sponsors

Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.
P&E Directions INC.

HOKEN NO MADOGUCHI GROUP INC.

(Insurance agent)

Hoken No Madoguchi Group Inc., an insurance agent company, has created a totally new approach to sales in the retail insurance market, by committing to a customer-centric approach.

Staff members actively listen to customers, to understand their specific needs, and then recommend the insurance products that best meet those needs. Staff members can choose from among the broad selection of insurance products on the market, regardless of whether the insurance companies are conducting any sales promotion campaigns. (In Japan, insurance agents are usually affiliated with one insurance company. Therefore, agents will frequently sell the insurance products of only one company. Hoken No Madoguchi operates independently of the insurance companies.)

MonotaRO Co., Ltd.

(E-commerce retailer of indirect materials)

MonotaRO operates an e-Commerce retail site for industrial supply products, specifically the indirect materials used in the production process. “Indirect materials” include consumables, small equipment, and the components necessary for maintenance, repair, and operations (MRO) at factories. The company’s customers are primarily small and medium-sized factories, construction contractors, and auto repair shops.

MonotaRO is able to save customers time and effort in the procurement of indirect materials—items that they would normally buy only in small amounts. Moreover, the company maximizes customer convenience by maintaining a vast inventory of the kinds of items that customers purchase infrequently. MonotaRO has adopted an open and fair “one-price policy,” which eliminates customers having to ask every time for a price quote and then engage in price negotiations. It also simplifies: (1) product searches; (2) the order placement process; and (3) the process for confirming deliveries. In addition, the company has been able to attract customers from new segments by expanding the variety of merchandise it carries. At the same time, MonotaRO has successfully increased sales to existing customers by continuously improving the convenience of the shopping experience.

RIZAP GROUP Inc., Body Making Business

(Private physical training studios)

RIZAP, Inc.’s Body Making Business “is absolutely committed to producing results,” specifically, attaining the fitness goals that have been agreed upon by individual customers in twice-weekly training sessions with their designated personal trainers, either at the training gym, or through daily consultations about diet and activities, conducted via smartphone.

RIZAP invests in R&D, and has developed an approach to “body sculpting” that is based on scientific evidence. The company has also developed a system for predicting changes in body weight, based on the data of 100,000 customers who have experienced the RIZAP program. With its specialized training program and a system for predicting changes in body weight, the company can provide reliable services that are less dependent on each individual trainer’s skills.

Trusco Nakayama Corporation

(Wholesaler of indirect materials)

Trusco Nakayama is a wholesaler of indirect materials (the secondary manufacturing materials that are indispensable to all manufacturing sites). The company’s primary merchandise is “MRO” (maintenance, repair, and operations) products. MRO products include the tools and consumables used in factories.

The company had an inventory of 351,800 items, supplied by 2,416 manufacturers (as of the end of September 2018). The company has its own distribution system. Deliveries are made to most customers twice a day, in small lots of one or two items (even just a single screw driver). The company fills orders from its own inventory for about 89.9% of the orders received. With regard to the shipment of products kept in inventory, customers can receive those items either the same day the order is placed, or the next day.

Trusco’s name comes from the words “trust” and “company.” This name demonstrates the company’s commitment to earning trust. Indeed, Trusco Nakayama has won the trust of its customers, the majority of which are machinery tool dealers or online sales agents. They are confident that Trusco will have in stock the very product they need. The company does not appeal to customers on the basis of price. Rather, Trusco Nakayama, in developing its unique value chain, has made customer convenience its priority.

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

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General features of insurance agent in Japan

Sales of insurance products are conducted either by the employees of insurance companies, such as the sales representatives of life insurance companies, or by agents. (In Japan's life insurance industry, the common practice was for an insurance company's sales representatives to approach individuals at their workplace, and deliver a sales pitch for their company's insurance products. This was the dominant sales channel for life insurance in Japan until 2005, when the Law Concerning the Protection of Personal Information made it difficult for the sales representatives of insurance companies to call on individuals at their workplaces.) Insurance agents include exclusive agents who represent only one insurance company, and other agents that sell insurance products from several insurance companies. Other agents include: (1) specialized agents (such as "Life Planners," dedicated agents who exclusively represent a single foreign life insurance company; insurance agents who represent casualty insurance companies; online insurance shops; insurance agents that make sales calls; and insurance agent shops that do not make sales calls); and (2) part-time agents, whose main business is something other than an insurance agency (e.g., banks, automotive dealers, and auto-repair shops). Following the deregulation of the insurance industry, new entrants have led to this market's further diversification in recent years. Insurance agents can sell both life insurance and casualty insurance, depending on the terms of the agent agreement that has been signed with each insurance company. These days, other agents will often have signed agent agreements with about 40 insurance companies, (including both life insurance and casualty insurance companies).¹ Meticulous explanations are necessary in the selling of insurance products—customers must understand well the breadth of policy coverage and insurance conditions. Recently, the Japanese authorities prohibited sales activities by third-party sales representatives not regularly employed by insurance agents. The reason behind this prohibition was to require insurance agents to improve their communication with customers, reflecting growing concerns regarding the education of staff members and the monitoring capabilities of the insurance agents.

Japan's life insurance market is the second largest after the U.S., with annual premiums written totaling about 40 trillion yen (US\$353.3 billion). The casualty insurance market amounts to about 8 trillion yen (US\$70.6 billion) per year. According to research² conducted by the Japan Institute of Life Insurance, 88.7% of Japanese households have life insurance, which is one of the highest rates in the world. On average, a single household has 3.9 life insurance policies, and pays insurance premiums totaling 382,000 yen (US\$ 3,375) per year. Still, only 21.9% of households have purchased personal pension insurance; 14.1% have bought nursing care insurance plans or nursing care special contracts; and 12.0% have disability income replacement insurance

¹ There were 41 life insurance companies in Japan as of October 2018. Of this total, 14 are Japanese subsidiaries of foreign companies; 4 are subsidiaries of casualty insurance companies; and 2 are insurance companies that sell insurance online, directly to customers. In casualty insurance, there are 26 companies, and the leading three groups dominate 88% of the market.

² Japan Institute of Life Insurance, Heisei 30 nendo seimei hoken ni kansuru zenkoku jittai chousa sokuhouban (National fact finding survey on life insurance 2018—Flash Report, September 2018) (in Japanese).

or some other type of insurance. The main channel for consumers wanting to obtain information regarding insurance products was the sales staff of insurance companies (46.5% of respondents), followed by insurance agents (15.8%). The channel from which the respondents purchased their most recent insurance product was the sales staff of insurance companies (53.7% of respondents), agents (17.8%), online or through a mail-order business (6.5%). Only 30.5% of respondents indicated that they are “knowledgeable about life insurance and personal pension insurance products,” while 66.6% replied that they “know almost nothing.” The results of this survey indicate that most people do not have confidence in their understanding of complicated life insurance products. Also, only 46.1% indicated that their insurance coverage is “sufficient,” while 35.5% replied “insufficient.” According to the same survey, the amount of insurance premiums that respondents felt they could afford to pay per year per household totaled 343,000 yen (US\$ 3,030) on average, and this was lower than the amount of their actual premiums. Combining these two pieces of information, it seems that most households need to decrease the insurance coverage they already have, and reallocate funds to areas deemed insufficient.

Unique Value Proposition

Hoken No Madoguchi Group operates Hoken No Madoguchi shops. There are 405 directly owned shops, 235 franchise shops, and 75 shops in 22 affiliated banks (as of June 30, 2018). With annual sales of 37.2 billion yen (US\$328.7 million), the company ranked number one among the insurance agents that published financial results in fiscal year 2017. Hoken No Madoguchi sells the insurance products of 27 life insurance companies and 16 casualty insurance companies. The best-selling products in fiscal year 2017 were: medical insurance, which accounted for the largest number of policies (24% of total sales); insurance for cancer and three major diseases (18%); automotive insurance (17%); whole life insurance (13%), fire and earthquake insurance (12%); term life insurance (8%); other casualty insurance (5%); pension plans, endowment life insurance policies, and educational endowment insurance plans (3%); disability and income replacement insurance (1%); and nursing care insurance (0.4%). Out of the 238 life insurance products that Hoken No Madoguchi offers, 237 products were sold.³

Customers learn about Hoken No Madoguchi Group through advertisements in the mass media, at shops located on high-traffic streets, and by word of mouth (i.e. recommendations from existing customers). Hoken No Madoguchi does not segment customers according to age group, family makeup, or annual income. The company’s staff members do not make sales calls to encourage prospective customers to consider purchasing insurance products. The company focuses on customers who are willing to visit Hoken No Madoguchi shops on their initiative. Such motivated individuals are already aware of the need for insurance coverage and the risks involved.

The value proposition of Hoken No Madoguchi is: (1) helping customers to identify the true source of their sense of uneasiness with regard to the future; (2) facilitating a deeper understanding of the risks they might eventually face; and (3) assisting customers in their selection of appropriate insurance products. The company views its sales activities at Hoken No Madoguchi shops not as “sales,” but rather as a chance for “collaboration with customers, helping them to clarify their thinking and voice their concerns.” These meetings with customers are accordingly called “consultations.” In these meetings, the staff members are referred to as “Life Partners.” During consultation meetings, the “Life Partners” actively listen to customers, and help customers learn about insurance products without using any technical terms. The aim is to help customers develop a clearer understanding of their values, future plans, and sources of uneasiness; and a proper understanding of insurance products. Customers can then make an appropriate selection, based on their needs and the amount that they can afford to spend.

On average, each consultation meeting takes about two hours. Most customers require two or three

³ Hoken No Madoguchi Group, *Okyakusama ni totte saiyuu no kaisha sengen ni kansuru gohouoku*, Sept. 28, 2018.

meetings before signing a contract. About 55% of the customers who visit Hoken No Madoguchi Shop purchase an insurance product. This performance is impressive, even taking into consideration the fact that customers who visit the company's shops are already aware of their needs. In contrast, the top-selling sales staff employed by life insurance companies, who make sales calls to prospective customers, can only achieve a contract rate of 7-8%, on average. Following the conclusion of a sales transaction, the customer will receive an insurance policy in the mail. After the policy has arrived in the mail, a company representative will contact the customer, and invite that person to stop by the shop. The company wants to make sure that the customer is satisfied with the policy's contents. This "follow-up" approach is called the "3 + 1" (three plus one) practice. (This follow-up meeting is the fourth consultation meeting after the three meetings held prior to the conclusion of a sales transaction.) About 70% of customers contacted by the staff members actually visit the shop again for a follow-up visit.

The second value proposition is providing customers with a long-term relationship and continuous customer care. Customers need to update their policies, with a change of address, for example. Customers send requests for payment, and provide the information required for payment. Other customers want to confirm that their coverage is still sufficient when their lives change unexpectedly, or when they suddenly face new uncertainties or challenges in their lives. Each year, two months before a customer's birthday, Hoken No Madoguchi will send a letter, Anshin No Wa Teikibin (lit. translation – "Circle of Reparation" Regular Notification) to encourage customers to confirm that they have sufficient insurance coverage. The company keeps its shops open 365 days a year, allowing customers to stop by at their convenience. Hoken No Madoguchi aims to be a friendly presence in the neighborhood, and encourages customers to stop by anytime. The company's broad network of shops, which totals 700 nationwide, provides a physical base for a long-term relationship with customers, even those who move to a house in a different area. One-fourth of the customers who visit a Hoken No Madoguchi shop for a consultation are existing customers. In 2017, the company had 812,000 customer meetings, of which 662,000 were "consultations." The rest of the meetings were for existing contracts, to update policies, and do paperwork to request payment. Out of 662,000 consultations, 499,000 were with new customers, and 163,000 were with existing customers. ⁴ The company sells two insurance products to each customer, on average. In 2017, the company sold 1.94 million insurance products to 927,000 customers. ⁵

Hoken No Madoguchi enjoys a high customer retention rate. For those customers who have made regular payments on their life insurance policies for 25 months, the retention rate is 95.4%. For those who did so for 37 months, the retention rate is above 93%. Both of these rates are above the industry average by a wide margin. As for automobile insurance, 90.4% of the customers renewed at Hoken No Madoguchi upon expiration after one year. ⁶

Unique Value Chain

The unique features of Hoken No Madoguchi's value chain is its "consultation meetings" and its approach to human resource management. These activities support its customer-centric understanding of customer needs and the selection of insurance products.

Purchase

Hoken No Madoguchi Group has concluded agency agreements with 27 life insurance companies and 16 casualty insurance companies. The company can meet the minimum sales requirement of these companies while respecting the choices made by customers because Hoken No Madoguchi can spread the sales over its 405 directly managed shops, at very least. The company can also enjoy the higher commissions that are often

⁴ Hoken No Madoguchi Group, Value Report 2018, p.21.

<http://www.hokennomadoguchi.co.jp/about/pdf/ValueReport2018.pdf> (accessed on November 1, 2018)

⁵ Ibid. p.21.

⁶ Ibid. p.22.

granted to high-performing agencies (i.e., achieving high-volume sales and realizing high-quality administrative operations).

Acquisition of new customers

Because Hoken No Madoguchi Group does not make sales calls, the company has to find other ways to raise customer awareness and encourage prospective customers to visit its shops. The company opens shops on streets with high foot traffic, invests in mass media advertising, utilizes the local media, and conducts web-based marketing. Ten percent of new customers were recommended by existing customers. Also, repeat visits by existing customers have been increasing by 20% every year.

Consultation meetings

Hoken No Madoguchi Group calls its meetings with prospective and existing customers “consultation meetings.” Rather than focus on making a successful product sales pitch, the highest priority of staff members is to actively listen to customers as they talk about their concerns. The goal is to help customers clarify their true needs. When the company’s “Life Partners” finally talk, their role is to help customers understand the kinds of insurance products that are available, without using technical terms. As a result, each consultation meeting takes two to three hours, and a customer needs two to three meetings, on average, before signing a contract. This is a long process, but customer satisfaction is high, and more than 50% of customers who visit a Hoken No Madoguchi shop buy some kinds of insurance product.

Hoken No Madoguchi has developed its own proprietary software, known as the “Life Design System.” The software guides the staff member through the process of inquiring about the customer’s situation, and confirming the customer’s needs. Based on the input created through this process, the software will recommend an appropriate selection of insurance products, from which the customer may choose.

Continuous customer care

After the customer receives an insurance policy in the mail, a representative of the Hoken No Madoguchi Group will contact that person to encourage a visit to one of the Hoken No Madoguchi shops. The staff member wants to confirm that the customer is happy with the insurance purchased. (This is what the company calls its “3+1” practice.) Also, the company encourages customers to make periodic visits to the Hoken No Madoguchi shops to make sure that their insurance coverage is still adequate. A staff member receives an update from the customer regarding life changes and their attendant risks. By establishing a long-term relationship with customers, the company can enjoy a high customer retention rate. It is trying to be “truly customer-centric” by serving customers for their entire lives, thus completing the customers’ Anshin No Wa (lit. translation – “Circle of Reparation.”)

Hoken No Madoguchi Group has developed a database of customers and insurance policies, making full use of the company’s proprietary system for insurance contract management and customer relationship management.

Development of Hoken No Madoguchi shop network/alliances

The Hoken No Madoguchi Group has expanded its nationwide network of shops faster than its competitors. This rapid expansion has been supported by the training system it has created to help employees improve their active listening skills. The company has also developed a highly successful approach to customer consultations, as well as extremely effective shop operations. In addition, the company employs a franchise system for increasing retail outlets, which are now called “partner shops.” The company has also added outlets by forming alliances with banks ⁷.

Human resource management

Hoken No Madoguchi Group recruits from outside the insurance industry, and provides training using

⁷ The insurance products available at the shops at affiliated banks are limited, compared with the products offered by directly owned shops and partner shops. When customers are interested in such products, they are encouraged to visit a directly owned shop or a partner shop.

the company's proprietary program. The company had 3,100 employees at the end of 2017 (more than 5,000 if partner companies that operate partner shops are included). The company is committing the maximum human resources, assets and money to employee training.

In July 2013, Hoken No Madoguchi Group adopted the corporate philosophy of being "an excellent and the most caring company for customers," and changed the goal of its training program from "selling more" to "mastering the (correct) mindset and skills." New employees attend an intensive five-day training program. Upon completion of this program, the new employees then undergo two months of preliminary basic training, conducted in Tokyo, Osaka and Nagoya. The primary focus of this two-month training period is to help new employees develop the mindset and skills they will need in their face-to-face dealings with customers. They must perform their duties conscientiously and cordially. Employees practice by taking part in role-playing exercises, to learn the skills necessary for successfully fulfilling "the Seven Requirements for Being Open with Customers." All the employees of partner shops and affiliated banks who work at the insurance counter are required to complete these two training programs.

The Seven Requirements for Being Open with Customers⁸

1. Our work starts by actively listening, to identify our customers' true intentions.
2. Our basic job is to put ourselves in our customers' shoes.
3. Our responsibility as a business is to meet our customers' expectations.
4. We measure our business performance by how successful we are in earning our customers' appreciation.
5. Our goal as a business is to achieve a high level of customer satisfaction.
6. We find pleasure in our work by assisting customers and inspiring them.
7. Our work is finished when the customer says, "Thank you."

After the employees have started working at a Hoken No Madoguchi shop, they are encouraged to share their "best practices." The company puts a priority on creating a corporate culture of "mutual cultivation." To get a promotion, employees must acquire the necessary certifications, such as the national certification for financial planners.

In the insurance industry, it is standard practice to try to motivate the sales staff to sell as much insurance as possible by pegging their remuneration to their previous-month sales performance results. In 2015, Hoken No Madoguchi Group changed the remuneration system to one based on previous-year evaluations, which include sales performance. Employee evaluations are based on qualitative and quantitative key performance indicators (KPIs), which are derived from the performance goals set by each shop. In order to develop its workforce, the company puts a heavier weight on qualitative performance as employees reach the higher ranks. Qualitative evaluations now account for close to 90% of employee performance evaluations.

Fit among Activities

Hoken No Madoguchi Group made three choices that are central to its competitive strategy: (1) Create a trusting environment for customer consultations by refusing to side with an insurance company and push insurance products that are not in the customers' best interest; (2) communicate honestly with customers in consultation meetings; and (3) operate a network of ubiquitous shops, thus making the company's services easily accessible to all customers. Thanks to a broad product lineup and a consultation process that is not influenced by the sales promotion campaigns of insurance companies, Hoken No Madoguchi can offer customers a safe environment for consultations. Customers can be confident that the staff members do not select products for recommendation merely because of the substantial commissions such a sale might generate for insurance companies or Hoken No Madoguchi Group. Under such circumstances, it is possible to engage

⁸ Hoken No Madoguchi Group, Value Report 2018, p.2.

in honest communication during consultation meetings.

In hiring, the company targets individuals without any background in insurance sales, and makes it a practice to hire people from outside the insurance industry. Hoken No Madoguchi trains its staff members to develop their active listening skills. Employees are encouraged to adopt a customer-centric focus. The company also has established stable structures for work evaluations and employee remuneration. (Pay levels are fixed, and remuneration is no longer so dependent on an individual's ability to meet sales volume targets.) The large number of shops opened nationwide, as well as proprietary customer relationship management and insurance contract management systems make it possible for the Hoken No Madoguchi Group to serve customers without depending on the person in charge. Moreover, the company is able to cultivate long-term relationships with customers who must move to a new home in a different location.

By pursuing excellent customer service, the company has developed high-quality business operations that have contributed to the improved efficiency of insurance companies. The company can honor agency agreements that specify minimum requirements for sales volume without having to pitch any specific insurance products to clients for the sake of meeting sales quotas. (Please refer to Hoken No Madoguchi Group's activity system map, which appears at the end of this report.)

Innovation that Enabled Strategy

- Has developed a customer-centric process for insurance product selection and enrollment in an insurance plan. The standard practice in the insurance industry was for sales representatives to make sales calls on prospective customers by visiting them at their homes or offices, to discuss insurance products and raise their awareness of the need for sufficient insurance coverage. At Hoken No Madoguchi, customers visit the company's shops on their own initiative. Through consultations with staff members, customers can gain a deeper understanding of their specific insurance coverage needs, and select an appropriate product that meets their needs.
- Has created a human resources management system under which the staff of all Hoken No Madoguchi directly-managed shops are company employees. Under this system, employees face much less pressure to meet specific sales quota targets, unlike other salespeople working in the insurance industry.
- Has stimulated a new consumer behavior with regard to the purchase of insurance products (i.e., that act of visiting the shops of Hoken No Madoguchi agents to buy insurance). The company was able to bring about this major change in consumer behavior by first educating all employees (not only the company's employees, but also all the individuals employed at partner shops and affiliated banks). The result of this training is that customers can enjoy consistently high-quality consultation services. The company has been able to develop a reputation for good service, while expanding its network of retail outlets through a significantly lower capital commitment.

Trade-offs

- Does not consider "the selling of insurance products" its primary business activity. Instead, the company defines its mission as: "Delivering peace of mind and security, smiles and happiness through the provision of insurance products." Accordingly, achieving sales targets on a volume basis is not the ultimate goal. "Life Partners" sometimes do not sell insurance products, recognizing that the customer already has sufficient insurance coverage. Employees at Hoken No Madoguchi are not rewarded for meeting sales targets. The majority of employees (including Life Partners) have fixed salaries. The company does not have each staff member compete in terms of sales performance. Rather, it takes into account the sales performance of individual shops and regional blocks, and views this as the aggregate (sum) of each staff member's performance. Hoken No Madoguchi is one of the best-selling agents for many insurance companies. However, the company does not participate in the sales award ceremonies held by insurance

companies.

- Is not an “agent” that sides with the insurance companies. As a provider of insurance products, the company remains an independent entity. Hoken No Madoguchi aims to satisfy both customers and insurance companies.
- Does not ask “Life Partners” to be responsible for new customer acquisition. Various practices are developed at the headquarters and in the shops to increase brand awareness. Individual “Life Partners” are not required to boost new customer acquisition numbers.
- Does not react to the sales promotion campaigns of insurance companies because such sales promotion campaigns go against the company’s policy to adopt a “customer-centric” approach. After actively listening to the customer and identifying specific needs, a staff member explains about the various insurance products available, and lets the customer select a product.
- Does not hire individuals from within the insurance industry. Because the company takes a unique approach to sales and human resource management, it is very different from the other companies in the industry. It is not easy to re-educate individuals who have been trained by other companies. The company has developed an in-house training program for people who do not have experience in the industry.
- Does not try to motivate employees by setting sales volume targets or quotas. Hoken No Madoguchi does not make insurance sales its ultimate objective. Accordingly, in employee performance evaluations, an extremely small weight is placed on the individual’s contribution to insurance product sales. This is a departure from the standard industry practice. Because adoption of this system would result in lower salaries for the high-earning sales staff employed under the conventional remuneration system, companies that employ a performance-based payment system would have difficulty switching over to this remuneration system.

Consistency of Strategy over Time

The 1996 amendments to the new insurance business law allowed life insurance companies to create subsidiaries to develop and sell casualty insurance, and vice versa for casualty insurance. This amendment also liberalized product design and prices for insurance companies, marking the beginning of the industry’s deregulation. It also created “insurance brokers,” who, for the first time, could sell the products of many different insurance companies. Then, in 2001, banks were allowed to start selling insurance products. Hoken No Madoguchi Group opened its first shop in 2000 in Kohoku Newtown, in Yokohama City, Kanagawa Prefecture. The staff of this very first shop did not make sales calls. Instead, the staff members waited for customers to stop by the shop and make inquiries. The staff members provided information on a variety of products, enabling customers to compare the products of different insurance companies. Around the same time, the company developed a basic style of consultation meetings, which is one that anybody can master with some effort.

The company has raised customer awareness by using advertisements and other means, instead of sales calls. The physical media has been evolving over time as the company has grown in size. Until the mid-2000s, when the company did not have so many shops, advertisements were put in free papers that featured classified ads. The company’s aim was to reach the local community. After the mid-2000s, as the number of shops increased and geographic coverage expanded, the company gradually began advertising more frequently through TV and other mass media. Recently, it has added web-based marketing, and has also introduced an online appointment service through smartphones. In the early years, shops were located on the second or third floor of buildings located on smaller streets, to take advantage of cheaper rent levels. After the mid-2000s, the company began opening shops on high-traffic pedestrian streets and high-visibility areas, such as shopping centers and commercial buildings in front of train and subway stations.

In April 2013, Yasuhiko Kubota, then chairman of the company, became chairman and president. He set the goal of changing the company to become thoroughly customer-centric, and launched the “21 Management Reforms,” while urging his staff to make no presumptions about anything. Under this initiative, Hoken No Madoguchi Group developed and practiced a customer-centric approach, which focused on clarifying customers’ needs and facilitating the product selection process through “consultation meetings.” In such meetings, the staff members were not expected to “sell” (aggressively push) insurance products. He also adopted a policy of not being swayed by the sales promotion campaigns of insurance companies. In addition, he introduced a fixed pay salary structure.

Profitability

Hoken No Madoguchi Group’s five-year average of the return on invested capital (ROIC) exceeded the industry average by a wide margin. The return on sales (ROS) underperforms the industry average slightly. Competitors’ profits include sales of an enterprise management system for insurance agents. (Profitability analysis was conducted by PwC Japan.)

Return on invested capital (ROIC) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
15.0%P	4.8%P	3.5%P	26.4%P	23.4%P	13.2%P

Inter quartile range (IQR) = 10.9 %P

Return on invested capital = Operating income / Average invested capital

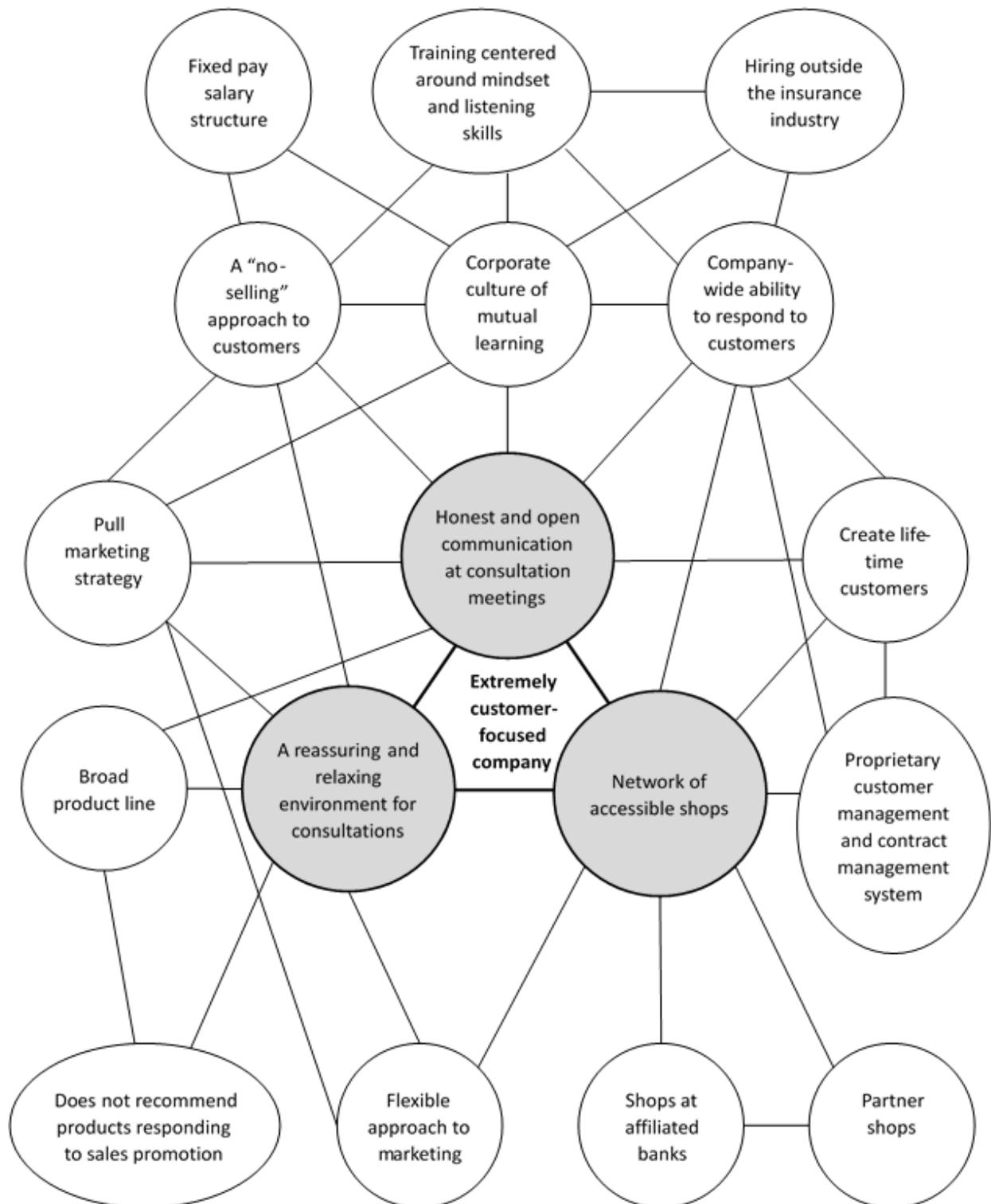
Return on sales (ROS) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
-1.6%P	-3.9%P	-5.0%P	4.7%P	-0.3%P	-2.0%P

IQR = 7.3 %P

Return on sales = Operating income / Net sales

Activity System Map of HOKEN NO MADOGUCHI GROUP INC.



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MonotaRO operates an e-Commerce retail site for industrial supply products, specifically the indirect materials used in the production process. “Indirect materials” include consumables, small equipment, and the components necessary for maintenance, repair, and operations (MRO) at factories. The company’s customers are primarily small and medium-sized factories, construction contractors, and auto repair shops.

MonotaRO is able to save customers time and effort in the procurement of indirect materials—items that they would normally buy only in small amounts. Moreover, the company maximizes customer convenience by maintaining a vast inventory of the kinds of items that customers purchase infrequently. MonotaRO has adopted an open and fair “one-price policy,” which eliminates customers having to ask every time for a price quote and then engage in price negotiations. It also simplifies: (1) product searches; (2) the order placement process; and (3) the process for confirming deliveries. In addition, the company has been able to attract customers from new segments by expanding the variety of merchandise it carries. At the same time, MonotaRO has successfully increased sales to existing customers by continuously improving the convenience of the shopping experience.

General features of the manufacturing and distribution industries for indirect materials in Japan

Indirect materials are called “MRO” items. Please note that these letters are included in the company’s name, MonotaRO. MRO is a three-letter acronym for “maintenance, repair, and operations,” which refers to the equipment and materials used in factories and on shop floors. (Indirect materials are used to make a final product, but do not become part of that final product.) Indirect materials include compressors, pumps, and other small equipment; drills and other tools; maintenance and repair items, like lubricating oil, mending tape, and putty; and consumables, like dust masks and gloves. Nowadays, “indirect materials” also include office supplies (e.g., personal computers, copier paper, writing materials, and fluorescent bulbs).

Indirect materials comprise many product categories. There are over 10 million SKUs, and more than 10,000 manufacturers in Japan and overseas. The majority are small and medium-sized manufacturers. There are just a few large manufacturers. End users are mainly manufacturers, auto repair shops, the factories of construction companies, and the contractors who work at construction sites. End users also include offices and individuals working on their own DIY home improvement projects. The market size for indirect materials in Japan, which was about 8 trillion yen (about US\$70 billion) in 2015, has remained at this level since the 1990s⁹.

The distribution channel for indirect materials is multi-layered: (1) nationwide first-tier wholesalers; (2) second-tier wholesalers; and (3) sales agents. This is because both suppliers and customers are large in number, but small in size. In Japan, the main channel for selling indirect materials to end users has been machinery tool dealers, who visit factories and take orders. Due to financial constraints, machinery tool dealers would normally carry only a limited number of items, and those items tended to be the best-selling national brand products. If a customer wanted a product that was not in stock, that item would have to be backordered. It would be delivered to the customer at a later date. Another challenge was the industry’s reliance on sales calls as the main sales practice. There is a limit to the number of customers that can be visited and the number of the geographic locations that can be serviced. These challenges were dealt with by dividing up sales territories geographically, and clearly demarcating sales territories for each vendor. Meanwhile, there has been a steady decline in the number of machinery tool dealers over the years. As is often the case, such companies are usually family-run businesses, and when aging business owners retire, business closures are quite common.

⁹ Ministry of Economy, Industries and Trade, *Shogyo Tokei* (lit. translation – Commercial Statistics).

Unique Value Proposition

The MonotaRO site is an efficient procurement platform that effectively uses IT (specifically, the Internet and database marketing). In Japanese, the word “mono” literally means “things or objects.” The name “MonotaRO” takes its inspiration from the Japanese folk hero “Momotaro,” and embodies both the company’s spirit and its mission to “fight against the old, unfair distribution system.” Customers would normally have to spend much time finding the desired product before placing an order. They would then have to wait for the items to be delivered. MonotaRO reduces the time customers spend procuring indirect materials by making it much easier for customers to search for products, inquire about price, confirm product availability, place an order, arrange payment, and confirm the delivery schedule. Customers use a huge variety of indirect materials. The price of a single commodity is relatively low, and many of the items are purchased infrequently. The individual making the purchase may have repeatedly purchased certain commodities in the past, but this accumulation of experience on the part of the purchaser does not increase the efficiency of the procurement process. Negotiating product prices and delivery schedules makes sense for direct materials, because customers buy a limited variety of products and tend to purchase the products in bulk. In the case of indirect materials, however, there is little to be gained by spending time on the procurement of such items.

MonotaRO’s target customers are small and medium-sized companies. Companies with less than 10 employees account for 32% of MonotaRO’s sales. Companies employing between 11 and 30 people make up 26%. Such companies conduct small-scale operations and purchase only a small amount of items. The majority of machinery tool dealers are unlikely to encourage their sales staff to make small and medium-sized companies a priority. As can be expected, most small and medium-size companies are not having their needs met. In terms of industry segment, manufacturers account for 41% of MonotaRO’s sales; construction, 18%; and auto repair shops, 12% (based on the sales volumes reported for fiscal year 2017. The number of employees is based on information optionally provided by customers at the time of membership registration. Companies must complete membership registration before they can start buying from MonotaRO.)

MonotaRO has a one-price policy to improve the efficiency of the procurement process for indirect materials. Before MonotaRO started its service, the standard practice in the industry was to withhold the price. This forced customers to make inquiries, and then negotiate a price each time. Price negotiations were possible because volume discounts were available. MonotaRO sets a price for each product (not the lowest price, but a reasonable one), and the price is listed on its website. MonotaRO does not negotiate on price. If customers are sufficiently happy with that price, they will not have to waste time looking for cheaper-priced items from other sales agents.

MonotaRO provides the convenience of one-stop shopping for a broad assortment of indirect materials. MonotaRO was selling more than 17 million products as of the end of October 2018. Nevertheless, customers can easily find what they want, thanks to the effective search function on MonotaRO’s e-commerce website. By analyzing the transaction data of more than 3 million customers, the company is able to recommend the appropriate product to customers at just the right time. Recommendations are personalized, targeting the interests and preferences of individual customers. In addition, MonotaRO issues 19 catalogues, each focusing on a different product category. When customers peruse these catalogues, they will often find appealing products that they had never considered buying. It has been the company’s policy to expand its product lineup over time. As a separate trend, customers tend to spend more on their purchases from MonotaRO as they continue to do business with the company.

MonotaRO also provides the benefit of a shorter delivery lead time. The company keeps about 400,000 products in inventory at its distribution centers. Products will be shipped the same day if an order is received before 3:00 p.m. MonotaRO also carries in its inventory a single unit of a product that rarely sells because customers would seldom buy that product, and what’s more, customers are not likely to buy more than one unit. Regarding products that are not in the company’s inventory, MonotaRO can take the order and have the item shipped the same day for 100,000 products, by working with its suppliers.

MonotaRO is able to provide quality products at reasonable prices. This is possible through the development of private brand products. By focusing the private brand on products with high expected sales volumes, the company can offer both quality and lower prices (compared with national brands). Private brand products include consumables such as cotton gloves and rubber gloves, office supplies like copier paper, cleaning supplies, blue sheets, and nuts and bolts; they comprise generic general-purpose items for which customers do not usually have a brand preference. Sales of private brand products accounted for about 20% of the company's total sales in 2017.

Unique Value Chain

The unique features of MonotaRO's value chain are the marketing, procurement, and human resource management functions. Using its superior data analytics capabilities, the company studies its merchandise mix, and continually makes adjustments, to better meet its customers' diverse needs. In addition, MonotaRO conducts experiments and introduces improvements that will make product searches and the procurement process more convenient for customers.

Merchandising and procurement

MonotaRO selects products and suppliers for each category, based on the results of research about customers' purchasing behavior and the market conditions for a given product. Depending on the analysis results, the company can decide whether to source an item from a manufacturer or from a wholesaler. The company has created teams that specialize in merchandising and procurement. The accumulation and sharing of know-how enable product categories to be expanded without having to substantially increase the size of the staff that handles merchandising and procurement.

When MonotaRO first starts selling a new product, it will order that item from a supplier after an order for that item has been received. Whenever possible, MonotaRO will ask the supplier to deliver the item directly to the customer. Once that item has achieved a certain frequency of sales, MonotaRO will begin carrying the item in its own inventory. Regarding general-purpose items that are expected to achieve a stable sales track record, MonotaRO will offer such products under its own private brand. In this way, MonotaRO is able to offer customers good-quality products at lower prices, and with a shorter delivery lead time.

Marketing

MonotaRO has developed its own original product database. This database contains extensive product information that allows for easy product comparisons. With the aim of making the product selection process a more pleasant experience for its customers, the company has: (1) improved its search logic; (2) upgraded its product recommendation function; and (3) created a system for customizing its services by enabling the swift and accurate functioning of the abovementioned features in response to specific actions taken by each individual customer. The company's sales techniques include e-mail messages, catalogues, fliers, and a combination of these. MonotaRO identifies the best approach for each customer by continually working to further improve accuracy (making full use of the analysis of data accumulated through machine learning), and by pursuing optimization utilizing tools such as the probability calculation of cost effectiveness and AB tests (a comparison of various patterns)

MonotaRO acquires new customers mainly through keyword searches on the internet. The company improves the chance for customers who conduct Internet searches to find the MonotaRO site through search engine optimization. Also, since 2013, the company has been advertising on television to raise brand awareness in the Osaka area. Since 2015, MonotaRO's TV commercials are being broadcast nearly nationwide (some geographic areas are excluded). Brand recognition for MonotaRO has reached 80% in areas where the company's TV commercials are broadcast.

MonotaRO has been issuing product catalogues from early on. (The company currently issues 19 catalogues, targeting different product categories.) Internet searches are conducted by customers who are

looking for a specific product. Catalogues, however, help customers discover entirely new products—ones that they did not know about before seeing it in the catalogue.

Distribution

MonotaRO has three distribution centers: (1) in Kansai region (the central western area of Honshu, which includes Osaka); (2) in the Kanto region (the eastern area of Honshu, which includes Tokyo); and (3) in Hokkaido (the large island in the northern part of Japan). Products in inventory will be shipped the same day that the order is received, but only if the order is placed before 3:00 p.m. on weekdays.

Human resource management

MonotaRO's first action guideline is "respect for others." This concept of "respect for others" is the core of its corporate culture. "Respect for others" is what enables MonotaRO employees, who come from various backgrounds, to work together and maintain a positive attitude. This commitment to maintaining respect for others helps the company to build healthy relationships with its suppliers and customers, and coexist with them in society.

Another core value of its corporate culture is the willingness to learn (i.e., to learn from one's mistakes). MonotaRO encourages its employees to: (1) frankly admit their own mistakes; (2) accept the mistakes of others; and (3) undertake small-scale experiments as a way to analyze and learn from data. The company also promotes mutual cooperation between employees. Employees are required to submit a report to their supervisor once a week, and have meetings with their supervisor on a weekly basis.

Fit among Activities

MonotaRO has made three core strategic choices that are central to its competitive strategy: (1) Continuous improvement of the search function; (2) continual increase in customer traffic to its website and expansion of its customer base; and (3) a shorter delivery lead time.

These three factors reinforce each other. The improvement of the search function is achieved through the analysis of data that has been accumulated as a result of the increased customer traffic. Meanwhile, increased customer traffic is supported by growth in the number of customers and the expansion of the product lineup. The growth in the number of customers is supported by: (1) expansion of the product lineup; (2) an increase in the number and quality of keywords connected to advertisement links on search engines; (3) search engine optimization; (4) mass advertising; (5) a shorter delivery lead time; and (6) an easy-to-use e-Commerce website. A shorter delivery lead time can be achieved through growth in the customer base, more widespread use of the site, and the resultant higher sales, which would enable the expansion of the product lineup carried in inventory. All of this is supported by investments to raise the efficiency of operations at distribution centers. (Please refer to MonotaRO's activity system map, which appears at the end of this report.)

Innovation that Enabled Strategy

- Created an efficient procurement platform (an e-Commerce website) that enabled the creation of a nationwide market for indirect materials. Previously, the market was divided up by geographic area, with numerous customers purchasing only a few items at a time, after selecting from a broad product lineup. The e-Commerce website makes product searches, delivery schedule confirmation, and order placement quick and easy.
- Introduced a one-price policy to the indirect materials market. The previous standard practice in the indirect materials market was to withhold pricing details. Customers had to ask for a quote, and then negotiate the price each time. By disclosing product prices, MonotaRO saves customers time and energy, as they no longer have to worry about price comparisons and negotiations.
- Discontinued the industry's standard practice of making sales calls and assigning dedicated sales staff to

the accounts of particular customers (except for a few sales staff members who exclusively handle the accounts of large corporate customers). MonotaRO has developed standard operational procedures for new customer acquisition and sales promotion to existing customers. (Both of these activities are conducted online.)

- Developed a corporate culture that embraces diversity (by hiring people with various backgrounds) and encourages experimentation. MonotaRO encourages employees to actively undertake experimentation on a small scale, and the company also tolerates failure.

Trade-offs

- MonotaRO's sales staff does not negotiate product prices or the terms and conditions of transactions with customers. The company has a one-price policy, and openly discloses the sales price for all of its products.
- Does not sell direct materials. If the company were to sell direct materials, price negotiations would be unavoidable because of the big impact that price has on the customer's profitability.
- Does not focus on products other than indirect materials. The determining factor for including an item in the company's product lineup is whether selling that product would help to improve the efficiency of the customers' procurement process. In its product lineup, MonotaRO does not focus on articles for daily use in offices.
- Does not operate its e-Commerce site as an online shopping mall. In a mall-style e-Commerce site, numerous sellers compete in terms of their product lineups and prices. Firstly, it would be difficult to provide the same kind of standardized information for each product. Secondly, the customer would have to move around from page to page, to see the prices and delivery schedules being offered by different merchants for any given item, and make comparisons.
- Does not seek to improve productivity by eliminating collaboration among employees. Short-term gains in productivity might be achieved if employees were to work autonomously. However, such higher productivity is not the company's goal. MonotaRO's priority is to continually improve the quality of its services. According to the company, this is best achieved when people work together and learn from each other's mistakes. For this reason, the company requires employees to submit weekly reports, and have weekly meetings with their supervisors.

Consistency of Strategy over Time

In 2000, MonotaRO was established as an e-Commerce retailer for indirect materials. Since the beginning, the company's value proposition has remained unchanged. MonotaRO aims to improve customer productivity by reducing the time and effort spent on ordering indirect materials. MonotaRO adopted a one-price policy from the very beginning, and considers the adoption of a one-price policy to be indispensable to the success of its value proposition. However, MonotaRO's commitment to openly disclosing product prices met with resistance from some manufacturers and wholesalers who did not want the product prices to be disclosed. Consequently, the company had much difficulty amassing the kind of broad product lineup that it offers today. Nonetheless, MonotaRO wanted to provide customers with the benefits of one-stop shopping. Starting out, MonotaRO selected small and medium-size manufacturing companies, ironworks, metal works and machine assembly companies as its first target customers. In selecting the merchandise it would offer, MonotaRO focused exclusively on the needs of these target customers. Back then, small and medium-sized factories seldom placed orders online. MonotaRO had to approach to these companies via fax and direct mail to collect their orders. In 2003, online orders accounted for less than 30% of total orders. Then, in 2004, Yahoo and Google started advertising businesses linked to keyword searches on the Internet. This is when MonotaRO began attracting new customers through the Internet.

MonotaRO added new target customers based on an analysis of its new customer acquisition, to determine from which industries the new customers were coming. The company expanded their target markets and merchandise lineup accordingly. The company added new product categories for auto repair shops in 2008; contractors and construction companies in 2009; research labs and R&D divisions in 2010; offices and shops in 2011; agricultural and kitchen equipment in 2014; and medical/nursing care facilities in 2015. Adding new product categories increases the sale of products that sell less frequently. MonotaRO will begin carrying an item in its own inventory once it has achieved a certain frequency of sales. Items kept in inventory mean a shorter delivery lead time for the company’s customers. To summarize, the company’s expansion of its target customer categories results in greater convenience for both existing and new customers. Thus, MonotaRO has created a true virtuous cycle. The company has enhanced customer convenience by providing private label products—primarily generic general-purpose items that are expected to generate steady sales. In this way, MonotaRO has succeeded in strengthening its value proposition, by providing good quality products at reasonable prices, with a shorter delivery lead time.

Although MonotaRO’s target customers have traditionally been small and medium-sized factories and offices, since about 2010 the company has been getting orders increasingly from the factories and offices of large corporations. The procurement of indirect materials in large corporations tends to be delegated to the local offices and factories (unlike the procurement of direct materials, which is usually centralized at the headquarters). MonotaRO has introduced purchasing management systems for large corporations (“MonotaRO One Source” in 2014, and “MonotaRO One Source Lite” in 2017). The company has also assigned sales representatives to each of its large corporate clients. In addition to these new initiatives, the traditional activities that MonotaRO developed for small and medium-sized customers are being used by the large corporate clients. In short, MonotaRO has been able to successfully serve large corporate clients while maintaining the core of its competitive strategy.

Profitability

MonotaRO CO., Ltd.’s five-year averages for the return on invested capital (ROIC) and the return on sales (ROS) exceeded 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					
5Yrs Avg.	2013	2014	2015	2016	2017
32.5%P	43.2%P	36.4%P	36.1%P	31.0%P	32.0%P

Inter quartile range (IQR) = 4.3 %P

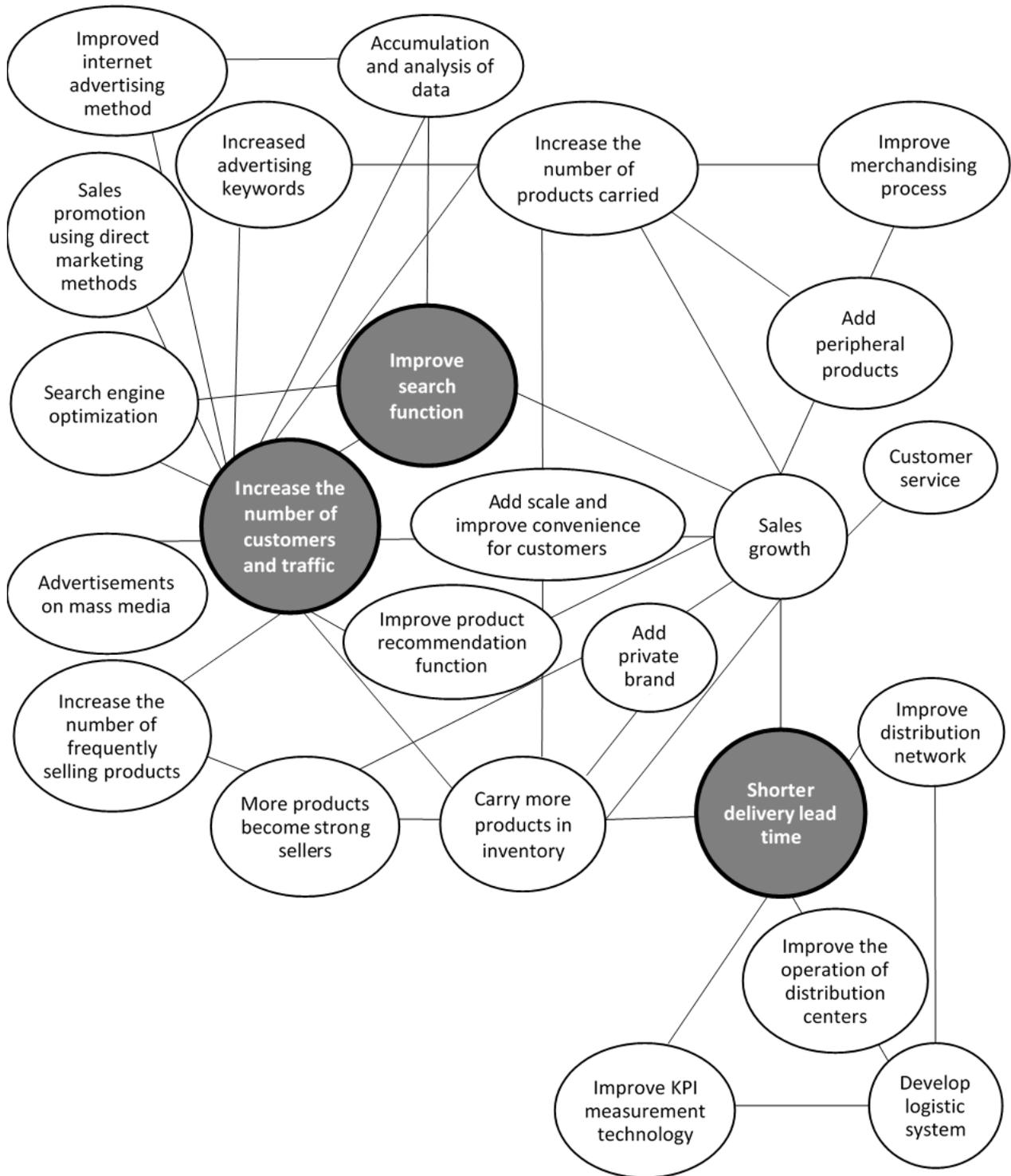
Return on invested capital = Operating income / Average invested capital

Return on sales (ROS) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
10.0%P	9.8%P	8.2%P	9.6%P	9.6%P	10.9%P

IQR = 3.1 %P

Return on sales = Operating income / Net sales



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

RIZAP, Inc., Body Making Business

RIZAP, Inc.'s Body Making Business "is absolutely committed to producing results," specifically, attaining the fitness goals that have been agreed upon by individual customers in twice-weekly training sessions with their designated personal trainers, either at the training gym, or through daily consultations about diet and activities, conducted via smartphone.

RIZAP invests in R&D, and has developed an approach to "body sculpting" that is based on scientific evidence. The company has also developed a system for predicting changes in body weight, based on the data of 100,000 customers who have experienced the RIZAP program. With its specialized training program and a system for predicting changes in body weight, the company can provide reliable services that are less dependent on each individual trainer's skills.

General features of the training gym market in Japan

The training gym market in Japan has been growing steadily since 2012¹⁰. This market, valued at 461 billion yen (about US\$4 billion) in 2017, increased by 2.9% from the previous year. The leisure market includes sports, hobbies and crafting activities, and entertainment, as well as sightseeing and excursions, according to a survey by the Japan Productivity Center. The sightseeing and excursion market during the same year rose 8% from four years earlier, due to growth in the number of international tourists visiting Japan. In contrast, hobbies and crafting activities decreased 6.8%, while entertainment fell 5.9% in the same period. The sports market grew 4%. Within the sports category, the training gym market increased 8.7%. The training gym market accounted for 11.3% of the sports market.

Industry observers attribute the growth of the training gym market to: (1) heightened awareness regarding extended healthy life-spans and the attendant risks that go along with longer life-spans, against the backdrop of an aging society; and (2) the growing number of Japanese people who are becoming more health conscious. Many Japanese companies are now also stressing the importance of health management to their employees. Simultaneously, with many new services being introduced, the selection of available services is becoming increasingly diversified. Services being offered include a performance-based reward system, 24-hour self-service gyms, small "women-only" studios, darkened room gyms, hot yoga studios, stretching-only workouts, and programs to prevent "locomotive syndrome" (i.e., reduced mobility) in seniors.

Unique Value Proposition

RIZAP, Inc.'s Body Making Business operates 120 training gyms, and hires 800 personal trainers. The company's service is unique because results can be achieved in a short time by maintaining a strict focus on the customer's fitness goals, and the staff is fully dedicated to helping customers attain their desired results.

The target customers are individuals who want to lose weight, transform their bodies, become healthier, and maintain the good results that they have achieved. In the early days, the majority of customers were women in their twenties and thirties who had a strong desire to lose weight. Then, men in their thirties and forties started enrolling in the RIZAP program. Now, RIZAP customers represent all age

Under the RIZAP program, a designated personal trainer will be with the customer every step of the way for the duration of the program. In the first counseling session, the customer and trainer together set the fitness goals to be achieved within the first two months. Customers visit the training studio twice a week for a workout session. In addition to the physical workouts, trainers also undertake rigorous monitoring of their

¹⁰ Japan Productivity Center, *Leisure White Paper 2018*. July 2018.

customers' dietary intake for every single meal, and provide nutrition advice. Customers are asked to report all meals and any snacks they eat. They must also report their body weight daily, via a smartphone application, "RIZAP touch." The trainer responds, giving advice and emotional support. The trainer's aim is to help customers modify their behavior, both in the studio and in their daily lives. The company provides customized exercise program and dietary advice that will differ from person to person, depending on the individual's age and lifestyle. In addition to the trainer, there are counselors who work with customers and provide support to help them make it through the plateaus. Dietitians are available to answer questions from customers 365 days a year. RIZAP's total number of customers has surpassed 120,000 (on a cumulative basis). It can be said that customers today are not as committed to losing weight as customers were in the company's early days. With the proper encouragement and support, even such customers can attain their fitness goals. If a customer stops coming to the gym, the trainer will stay in constant contact, via smartphone messaging and occasional phone calls. Such services help customers maintain their commitment to the RIZAP program, and make sure customers will not lose their motivation and give up part way through. This solid customer support system, coupled with an exercise program that has been developed based on empirical evidence and dietary advice increases the probability that customers will attain their fitness goals. The customer success rate for the RIZAP program is high.

When committing to a specific desired result, it is important to set realistic fitness goals, and it should be the right goal for the customer's body type. RIZAP encourages trainers, when they first start counseling new customers, to identify not only each individual's latent needs, but also any aspirations that have gone unvoiced. Trainers suggest to customers fitness goals that can realistically be achieved, taking into account the accumulated data of all other RIZAP customers in the company's database. The company has developed an algorithm for prognosticating weight-loss results based on the data of 120,000 customers who have taken part in the program, and use this data to determine a range of probabilistically feasible results. RIZAP uses this algorithm to provide individualized prognostications regarding realistic body weight and body fat goals. The RIZAP Method helps customers to envision the transformation they are likely to achieve in the near future, and set suitable fitness goals. Trainers are instructed not to set targets too low (making them too easy to achieve), but rather to set reasonable targets (ones that customers would likely consider to be "high" targets).

The value RIZAP provides is primarily a healthier body, but also, more importantly, psychological changes, which include the self-confidence that comes from achieving a goal, and behavioral changes.

RIZAP sets the price of its program higher than the industry average. The enrollment fee is 50,000 yen (about US\$440), and the fee for the two-month program is 298,000 yen (about US\$2,600). This includes 16 one-hour training sessions with a designated personal trainer at the training studio, daily feedback regarding meals and dieting, advice via a smartphone message service, and unlimited access to the studio for self-training. Although this fee is all-inclusive, it is very expensive, considering that the hourly fee charged by personal trainers in the industry is 5,000 yen (about US\$44.00). (Private brand products, such as supplements and low-carbohydrate diet food products sold at RIZAP, are as expensive as products by well-established brands.) Although the company offers the option to pay in installments, customers are asked to pay upfront for the two-month program.¹¹ This requirement forces customers to make a two-month commitment. Such a high price can be set because the company is fully committed to producing results. To prove its commitment, RIZAP offers a money-back policy. The company offers a 30-day money-back guarantee if a customer decides to quit within thirty days, regardless of the reason. Reasons might include changing the location of one's residence or becoming busier at work.

The company's long-term program, called "the Body Management Program," is available to those customers who have completed the two-month program. The goal of this program is to establish proper daily

¹¹ RIZAP offers an installment payment option, which 40 % of customers used in 2017.

habits to transform the body so it will not rebound. Customers are asked to make a one-year commitment for a monthly fee of 29,800 yen (about US\$260). With the help of a trainer, customers set fitness goals for one month, one year, and three years. Customers who fail to reach their initial target can extend the service with the same trainer for two more months at no charge. (This is known as “Rebound Insurance.”)

Average sales per customer in 2017 was 900,000 yen (about US\$7,900), indicating that a significant number of customers purchased additional services beyond the first two months. As an example, customers who weigh 100 kilograms (220 pounds) and want to reduce their weight to 60 kg (132 lbs) would need about a year and 1.5 million yen (about US\$13,000), according to the company. In 2017, 5% of customers got their money back or used “rebound insurance.”

Unique Value Chain

The value chain of RIZAP, Inc.’s Body Making Business is unique in terms of its R&D and its approach to human resources management.

Procurement

The supplements and low-carbohydrate diet food products sold by RIZAP are developed and manufactured by one of the subsidiaries of the RIZAP Group, Kenkou Corporation.

Research and Development

RIZAP’s training methods have been developed in collaboration with doctors, researchers and dietitians. The results of this collaboration have been compiled in the company’s Trainers’ Manual. This manual has gained the support of the Japan Trainer Association. RIZAP’s training methods have been improved over time, so that customers can attain their goals more efficiently and in a safe way, taking into account each customer’s age, gender and physical condition. The company maintains a database comprised of the digital records of 120,000 customers. The records document the physical transformation of RIZAP customers for the duration of their participation in the program. The company leveraged this data in developing the “RIZAP Navigator,” which prognosticates changes in body weight and body fat for each customer. The company has been undertaking tests jointly with researchers at universities and hospitals to prove the effectiveness of the RIZAP Method, and the results have been published.

The company has developed communication tools for helping trainers to stay in touch with customers outside of the training studio. Such tools include the “RIZAP touch” smartphone application, which features a message service, allowing customers to: (1) post updates regarding their daily meals; and (2) ask questions and get advice from trainers and specialists.

The company has arranged alliances with 170 medical institutions, and all of RIZAP’s 125 training studios in Japan have partnered with hospitals and clinics in the neighborhood. At the time of enrollment, if any health-related concerns are identified, the company will introduce the prospective customer to a partner medical institution, which will conduct a medical checkup, make recommendations, and give advice regarding whether the RIZAP Method is suitable for that individual. Trainers can ask doctors for advice if questions arise while they are providing support to their customers.

Individual coaching by designated personal trainers

RIZAP’s trainers provide customers with an exercise program and a diet that has been geared to the individual. Workouts with the trainer are twice a week. Therefore, the success of the program will depend on how customers use their time outside the gym. It matters what they eat and what they do. Trainers can extend support to customers on a daily basis via the smartphone. Customers can use their smartphones to post daily detailed information about their meals and snacks. Trainers evaluate their food choices using a five-point scale, and send some comments. Customers must record their body weight on a daily basis, and they can get advice from dietitians and counselors.

Marketing

RIZAP has raised brand awareness for its Body Making Business by aggressively investing in TV advertisements and posters in major train and subway stations. The level of recognition for the RIZAP brand in the Kanto area (which includes the greater Tokyo metropolitan area) has reached 74%.

New customers introduced by existing customers will receive a 50,000 yen (about US\$440) coupon. (This, in practice, is the waiver of the 50,000 yen enrollment fee.) Partner medical institutions will introduce patients who need to shed body weight to reduce the burden on their knees and those patients with lifestyle-related diseases.

After-sales services

Regardless of the reason, if a customer is not happy with the service, RIZAP will return in full the money received from the customer if the request is made within the first thirty days. Once customers have completed the two-month program, they can choose whether to go on and enroll in the gentler “Body Management Program.” This follow-up program, which focuses on the maintenance of one’s fit body, involves less frequently supervised training sessions at the studio. Body Management Program, customers can receive free additional service for two months if not satisfied. (This is what is known as “rebound insurance.”)

Studio development

All RIZAP studios are under the company’s direct management. Undertaking direct management of gym operations allows the company to dispatch trainers to different studios, responding flexibly to changes in demand among gyms. RIZAP gyms are not equipped with swimming pools, saunas, or any other large-scale equipment. As a result, RIZAP can take advantage of a much wider selection of locations when looking for a new site. Also, all customers are members—individuals who visit the studio for a specific purpose. Therefore, the studios do not have to be located at street level or at highly visible locations (such as streets with high foot traffic). The studios can be located in the basement, or even on the second or third floor of a building, which reduces the rent significantly.

When RIZAP opens a new studio in a new area, it can estimate the market size after seeing the kind of response the company’s advertising gets. RIZAP can minimize risk by starting out with a small studio, and then gradually increasing the size of its studio to a larger one (large studios usually have ten trainers). All RIZAP studios are equipped with private booths.

Human resources management

RIZAP hires all its trainers as full-time employees. When the company recruits, it does not require that applicants have experience in the industry. The company attracts many applications. In 2017, only 3.2% of total applicants were hired. Those who are newly hired must undergo 192 hours of rigid training at the RIZAP Academy. The curriculum includes personal training fundamentals (specifically, the knowledge and skills that a personal trainer requires), physiology, nutrition, training psychology, and the business of personal training. Upon completion, only those participants who pass a very demanding examination will be assigned to a RIZAP training studio.

After being assigned to a studio, trainers are required to participate in periodic training programs. Also, personal trainers have the option of learning through an E-learning system. Anyone who wants to become a studio manager or a supervisor must get certified through the company’s in-house certification system. Individuals who wish to advance their career path as a trainer can become a coaching trainer. The company also offers in-house certification for coaching trainers.

Trainers are evaluated by their ability to provide customers with a high level of attentiveness and support. Specifically, trainers are evaluated according to: (1) the number of times a customer had used the studio within the contracted period; (2) how frequently the trainer communicated with the customer via the “RIZAP touch” app (i.e., providing comments about dietary intake after grading the customer on a five-point scale); and (3) the degree to which the customer had achieved the agreed-upon fitness goals.

The attrition rate of trainers is in the single digits. This is relatively low, considering the fluidity of the job market for personal trainers. This includes those new trainers who quit before completing the 192-hour training program. Hence, the attrition rate of the trainers working at the studios are even lower.

Fit among Activities

RIZAP, Inc.'s Body Making Business made three core strategic choices: (1) Deliver highly attentive customer support, and make this support always available to customers; (2) Demonstrate that RIZAP's brand equity is its commitment to results (or, in other words, its commitment to the customer's success); and (3) Educate personal trainers, and assess their performance. (The effective development of personal trainers is what enables the other two strategic choices.)

RIZAP's Body Making Business is able to provide highly attentive customer support, and make its services always available to its customers because of: (1) a proprietary approach to "body sculpting" (called the "RIZAP Method"), which is backed by scientific evidence; and (2) the development of personalized training menus using the "RIZAP Navigator," a database that contains the actual data of all RIZAP's customers to date. In addition, the company's dedicated personal trainers can provide customers support and exert a positive influence on their actions in their daily lives through the use of the "RIZAP touch" smartphone application.

RIZAP's brand equity (i.e., the confidence to commit to results) is supported by: (1) the trust that the RIZAP Method has earned through supervision by specialists and joint research with universities and hospitals; (2) reliable services that do not depend on the skills of an individual trainer; (3) a full refund policy (the "money-back policy") and rebound insurance; and (4) aggressive marketing that demonstrates the results that have been attained through the successful completion of RIZAP's program.

Finally, the company uses a proprietary curriculum to educate personal trainers at the RIZAP Academy, and employs a performance evaluation system that makes "attentiveness to customers" the top priority. These two factors make possible the provision of highly attentive customer support, and are also the reason why the company can commit to results. (Please refer to the activity system map of RIZAP, Inc.'s Body Making Business, appearing at the end of this report.)

Innovation that Enabled Strategy

- Has selected as its value proposition "the commitment to results" (specifically, the customer's fitness goals) for its Body Making services, despite large differences in customers' body types. Moreover, the company has developed methods for consistently and successfully producing results. These methods tend to eliminate differences in the performances of individual personal trainers.
- Has developed in-house a large variety of training techniques for body sculpting. Goals include weight loss, weight gain (muscle building), and leg shaping. The system was developed based on scientific evidence for different body types, under the supervision of a team of specialists (including doctors, dietitians, sports science experts, and psychologists).
- Has developed a proprietary prognostication system, backed by the cumulative data of the 120,000 customers who have experienced the RIZAP Method. By entering customer's information, such as body type and lifestyle, the program will simulate changes in body weight and body fat; predict when a plateau will occur; and estimate how long it will last.
- Has developed methods for influencing a customer's dietary intake and other daily habits utilizing the "RIZAP touch" smartphone application. This app enables trainers to communicate with customers when they are outside of the studio. Trainers provide advice regarding daily intake (meals and snacks), nutrition, and physical activity in daily life.

- Has created a curriculum that develops personal trainers who share the corporate philosophy of “being absolutely committed to the customer’s success,” and understand the value of “self-transformation” from the customer’s perspective. The program also equips trainers with an extensive repertoire of body-sculpting techniques.
- Has introduced a money-back guarantee and rebound insurance for the RIZAP Body Management Program.

Trade-offs

- Does not require personal trainer experience when recruiting new trainers. RIZAP believes that the most important trait for trainers is the ability to commit to a customer’s fitness goals, and the willingness to be available to customers and provide highly attentive customer support.
- Does not assign multiple trainers to one customer. The assignment of a dedicated personal trainer to each individual customer makes appointment scheduling less flexible and limits the number of customers that can be served under this system. Regardless, the company believes that only a dedicated personal trainer will be able to provide highly attentive customer support and be with that customer every step of the way for the duration of the program.
- Does not compete on price.
- Does not allow customers to become inactive members.
- Does not have large facilities such as swimming pools or saunas in RIZAP training studios.

Consistency of Strategy over Time

RIZAP opened its first training studio in February 2012, in one of the busiest areas in downtown Tokyo. Since the very beginning, RIZAP has been training customers using its own proprietary body-sculpting method, which was developed in collaboration with specialists from various fields. Personal trainers fully commit themselves to the attainment of the fitness targets that the customer has selected. They demonstrate their commitment by remaining in contact with customers even during the hours spent outside the studio. For example, trainers provide rigorous monitoring of the customers’ diet and provide feedback. The practice of assigning a dedicated personal trainer to each individual customer—the core of its strategic choices—has remained unchanged since the company launched its business.

Before opening its first gym in 2012, RIZAP had created a proprietary fitness regimen that enabled participants to lose weight in a short time. This program was developed in collaboration with psychologists, kinesiologists, physiologists, and dietitians. The company developed personal trainers who were able commit themselves to the attainment of the fitness goals selected by the customers. These trainers would be with their customers every step of the way, to keep up their motivation and help them achieve their fitness goals. The company’s prices have remained unchanged since the beginning. RIZAP charges an enrollment fee of 50,000 yen (about US\$440), and 298,000 yen (about US\$2,600) for a two-month program. The company has also offered a money-back guarantee from the beginning. In 2013, RIZAP ranked No. 1 in customer satisfaction in the personal training market; No. 1 in popularity in the private gym market; and No. 1 in sales in the private gym market, according to a survey conducted by Neo Marketing, Inc.

In January 2015, the company established the RIZAP Academy, to produce a larger number of trainers who can follow the RIZAP Method. Trainers that complete this program are sent to the company’s new training studios.

In July 2017, the company introduced its Body Management Program for customers who had achieved their initial fitness goals, to help them maintain the fit body that they had achieved. Under the Body

Management Program, the company offers training sessions twice a month, conducted by a designated personal trainer at a RIZAP studio. The personal trainer also offers continuous support via smartphone for 29,800 yen (about US\$260) per month.

RIZAP entered the BtoB market segment (i.e., employee welfare programs for private corporations) in 2016. The company then teamed up with local governments to provide health management programs in 2017. To corporate clients, the company sends a trainer eight times in three months to provide lectures and lead workout sessions for company employees. In this setting, a trainer can coach a lot of customers. This is different from RIZAP studios, where customers receive one-to-one instruction. For everyday coaching, the trainer supports group leaders, who, in turn, support group members by undertaking continuous monitoring to promote behavioral modifications. In March 2017, RIZAP launched a pilot program for the local government of Makinohara City, in Shizuoka Prefecture, with 23 senior citizens participating. The program effectively reduced the participants' physical age and body weight (without reducing muscle, but shedding body fat). In August 2017, the company announced the "RIZAP Declaration to Bring Health and Fitness to 10 Million People." The aim of this project was to have 10 million people experience the RIZAP Method by 2020. For three months, from January to March 2018, RIZAP worked with the senior citizens of Ina City, in Nagano Prefecture. The company provided exercise and dietary advice to 46 senior citizens, following the RIZAP Method. Out of 46 participants, 36 measured their physical fitness age, and 35 had reduced their physical fitness age by more than 10 years. As part of this initiative, RIZAP introduced a payment system based on a contingency scheme, with the company being compensated for the actual results achieved. The company was compensated for the total of: (1) 50,000 yen (about US\$440) per person for participants who saw their physical fitness age go down by 10 years or more; or (2) 50% of the gap between the reduction in medical costs for participants and (1) above. To improve the payment scheme, the company is studying the RIZAP program's contribution to the participants' reduced medical costs, and the timing when the program's impact on medical costs appears.

Profitability

RIZAP, Inc.'s Body Making Business had five-year averages for return on invested capital (ROIC) and return on sales (ROS) that exceeded 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					
5Yrs Avg.	2013	2014	2015	2016	2017
34.9%P	541.5%P	35.3%P	83.5%P	33.2%P	21.9%P

Inter quartile range (IQR) = 12.1 %P

Return on invested capital = Operating income / Average invested capital

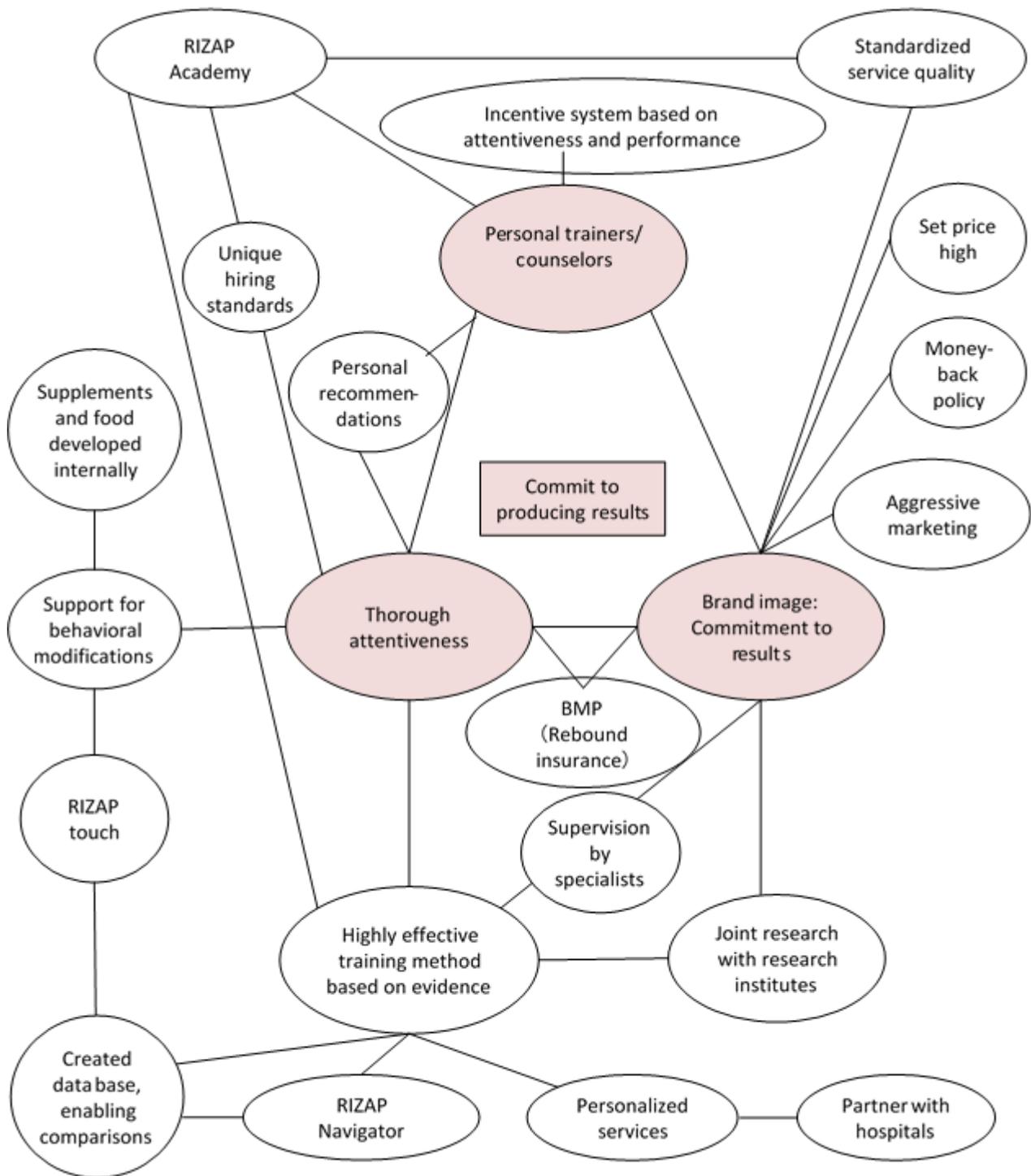
Return on sales (ROS) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
4.8%P	-3.2%P	-4.0%P	8.5%P	8.3%P	7.2%P

IQR = 7.4 %P

Return on sales = Operating income / Net sales

Activity System Map of RIZAP, Inc., Body Making Business



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

Trusco Nakayama Corporation

Trusco Nakayama is a wholesaler of indirect materials (the secondary manufacturing materials that are indispensable to all manufacturing sites). The company's primary merchandise is "MRO" (maintenance, repair, and operations) products. MRO products include the tools and consumables used in factories.

The company had an inventory of 351,800 items, supplied by 2,416 manufacturers (as of the end of September 2018). The company has its own distribution system. Deliveries are made to most customers twice a day, in small lots of one or two items (even just a single screw driver). The company fills orders from its own inventory for about 89.9% of the orders received. With regard to the shipment of products kept in inventory, customers can receive those items either the same day the order is placed, or the next day.

Trusco's name comes from the words "trust" and "company." This name demonstrates the company's commitment to earning trust. Indeed, Trusco Nakayama has won the trust of its customers, the majority of which are machinery tool dealers or online sales agents. They are confident that Trusco will have in stock the very product they need. The company does not appeal to customers on the basis of price. Rather, Trusco Nakayama, in developing its unique value chain, has made customer convenience its priority.

General features of indirect materials manufacturing and distribution industries in Japan

MRO is a three-letter acronym for "maintenance, repair, and operations," which means the equipment and materials used in factories and on shop floors. This refers to the indirect materials that are used to make the final product but do not become part of that final product. Indirect materials include compressors, pumps, and other small equipment; drills and other tools; maintenance and repair items, like lubricating oils, mending tape, and putty; and consumables, like dust masks and work gloves. Nowadays, MRO also includes various other indirect materials, such as office supplies (e.g., personal computers, copier paper, and fluorescent bulbs).

Indirect materials comprise multiple product categories. The commodities are supplied by a vast number of suppliers, and each supplier serves a large number of customers. There are over 10 million SKUs, and more than 10,000 manufacturers in Japan and overseas. The majority are small and medium-sized manufacturers. There are just a few large manufacturers. End users are mainly manufacturers, auto repair shops, the factories of construction companies, and the contractors who work at construction sites. End users also include offices and individuals working on their own DIY home improvement projects. The market size for indirect materials in Japan, which was about 8 trillion yen (about US\$70 billion) in 2015, has remained at this level since the 1990s.¹²

The distribution channel for indirect materials is multi-layered: (1) first-tier wholesalers, operating on a nationwide scale; (2) second-tier wholesalers; and (3) sales agents. Both suppliers and customers alike are large in number, but small in size. Trusco Nakayama was founded in 1959 as a wholesaler of machinery tools and indirect materials. In the 60 years since the company's establishment, none of the new market entrants have succeeded in growing beyond a certain size. It is difficult to grow a company in this market, given the large number of manufacturers, the vast array of products, and the degree to which customers are geographically spread out.

In Japan, the main retail channel for indirect materials has been machinery tool dealers, who visit factories and take orders. Machinery tool dealers have extensive knowledge of the highly specialized items and equipment intended for professional use, and they make a concerted effort to supply such items. They build a relationship with the customer's procurement department. As part of their order-taking duties, they share their knowledge with customers and listen attentively to their customers' questions and requests. Dealers

¹² Ministry of Economy, Industries and Trade, *Shogyo Tokei* (lit. translation – Commercial Statistics).

must respond to the specific requests of their customers (the factories). However, due to financial constraints, machinery tool dealers would normally carry only a limited number of commodities, and those items tended to be the best-selling national brand products. If a customer wants a product that is not in stock, it will have to be backordered, and the product will be delivered to the customer at a later date. Another challenge has been the industry's reliance on sales calls as the main sales practice. There is a limit to the number of customers that can be visited and the number of geographic locations that can be served. These challenges have been dealt with by dividing up sales territories geographically, and clearly demarcating sales territories for each dealer. Meanwhile, there has been a steady decline in the number of machinery tool dealers over the years. As is often the case, such companies are usually family-run businesses, and when aging business owners retire, business closures are quite common.

The e-Commerce retail sales of indirect materials (pioneered by MonotaRO in 2000) have been growing rapidly while continually attracting various kinds of end users.

Unique Value Proposition

Trusco Nakayama sources its inventory from 2,416 suppliers, and sells to 5,327 sales agents (as of the end of September 2018). Out of the 2,416 suppliers, 2,224 are Japanese companies. Machinery tool dealers, together with welding material dealers account for 80.7% of sales (on a value basis). Their customers are factories and construction-related businesses. The second-largest customer segment is online sales agents, who comprise 12.5% of sales. Online sales agents sell to a wide variety of customers, ranging from factories to consumers. The third-largest customer segment is home centers and pro shops that specialize in professional-use tools and materials. Home centers (large-scale retailers) and pro shops make up 6.3% of sales, and these retailers sell to construction contractors and consumers. The remaining 0.5% comes from international sales. Overseas dealers provide support for the overseas operations of Japanese customers, and local machinery tool dealers are their customers. Through these retail channels, Trusco Nakayama can reach more than 1 million end users. Of the one million users, large and medium-sized companies account for about 200,000; small companies and consumers comprise the majority, at about 800,000.

Trusco Nakayama has both the broadest product line in the indirect materials wholesale industry, and the largest number of items carried as inventory. The company sells about 1,730,000 items. Regarding its inventory, 351,800 items are kept at one of Trusco Nakayama's 22 distribution centers in Japan (as of the end of September 2018). The percentage of items shipped from inventory is 89.9% of the orders received (as of the end of September 2018).

The first value proposition that Trusco Nakayama offers the sales agents of indirect materials is the convenience of one-stop shopping for as many as 1,730,000 items. The company also provides a shorter delivery lead time for those items. Customers place an order via the company's e-Commerce website, "TRUSCO Orange Book.Com" or the company's catalogue, "TRUSCO Orange Book," which carries 359,800 SKUs. On the procurement side, the company's electronic purchasing site, "Orange Commerce," is linked to 307 companies and 1,204 factories (as of the end of September 2018). Of all orders received, electronic orders accounted for 81.6% (as of the end of September 2018). The company charges a fee for the TRUSCO Orange Book. The company charges 15,660 yen (about US\$137) for 10 volumes (this amount includes tax). Despite this relatively high price, the company sells about 240,000 copies every year. Trusco Nakayama has 22 distribution centers, 75 sales offices, and 2 headquarters. Thirty-one sales offices carry inventory.

The second value proposition is helping customers (who are sales agents) to reduce their inventory while simultaneously providing the commodities they need to expand their lineup of merchandise. The majority of machinery tool dealers are family-owned businesses that are deeply rooted in the local community. For them, carrying and managing large inventories is a burden, both financially and also managerially. Trusco Nakayama carries its own inventory even for long-tail products (items that sell less frequently). As a result, it has established a reputation for being reliable. Customers say, "Trusco will have it." In addition, the company

accepts orders for small lots, so customers can order even just one screwdriver, and have it delivered to them. Most of Trusco Nakayama's customers can receive their deliveries the same day the order is placed or the next day, because the company makes deliveries twice a day. In a sense, the company delivers "the necessary goods in the quantities needed, when they are needed." Sometimes, other wholesalers of indirect materials will buy from Trusco Nakayama. This is because it takes time and involves an additional cost when buying in small lots from a manufacturer. (Manufacturers do not have a system for shipping items in small lots.) Trusco Nakayama will accept returns free of charge when the product has been sourced from its inventory. As a result, sales agents can reduce their inventories without any worries, while still making it possible for their customers to order from a broad product lineup.

The third value Trusco Nakayama provides is operational support to customers that are sales agents. The company encourages customers that operate e-Commerce sites to connect their systems. Trusco Nakayama shares its product database (covering 1,730,000 items) with a limited number of customers. The company also allows users real-time access to inventory data, and has arranged for products to be delivered directly to the end users. As for the customers that operate home centers, Trusco Nakayama helps them to: (1) develop store-branded products; (2) improve the store floor layout and product displays; and (3) help establish links between brick-and-mortar operations and the e-Commerce business.

Trusco Nakayama does not pursue a low price. Customers decide to buy from Trusco Nakayama primarily because of the convenience it offers, such as quick deliveries. Still, customers are hoping to get a reasonably low price.

Mr. Tetsuya Nakayama, President of Trusco Nakayama Corporation, wants to create a situation where customers have no choice but to buy from Trusco Nakayama, even if they do not want to. In other words, the company wants to be indispensable to customers. He believes that customers who buy from Trusco Nakayama just because they like Trusco might stop buying from Trusco if their feelings about the company were to change for any reason.¹³ The quick delivery of small-lot orders (even only one or two items) is an indispensable service for customers, and would be difficult for competitors to imitate with the same degree of efficiency. Mr. Nakayama wants each employee to think more about how to improve the customer's business and less about getting orders.¹⁴

The value that Trusco Nakayama provides its suppliers is access to 5,327 sales agents and more than one million end users. The combined sales of the top seven wholesalers of indirect materials came to about 736 billion yen (about US\$6.5 billion), and Trusco Nakayama was the leader, with a 26.5% share of the market in fiscal year 2017.

Unique Value Chain

The unique features of Trusco Nakayama Corporation's value chain is its R&D, procurement, supply chain management, and human resources management.

Merchandising and procurement

Trusco Nakayama's product line focuses on the indirect materials used for manufacturing. The company does not sell the types of products that consumers would use in their daily lives. The company has expanded its product line, and has also increased the number of items carried as inventory. Trusco Nakayama had 36.4 billion yen (about US\$320 million) worth of inventory in fiscal year 2018, when its sales were 213 billion yen (about US\$1.9 billion). The number of items that the company sells increased from 830,000 in 2008, to 1,662,400 in 2017. In short, the company's product line doubled over a period of about nine years. In addition, the number of items sold as private brand products grew from 25,000 to 50,200 items during the same period. Sales of private brand products came to 40.1 billion yen (about US\$350 million) in 2017. Trusco

¹³ Mr. Tetsuya Nakayama, President of Trusco Nakayama Corporation, interviewed by the author on October 3, 2018.

¹⁴ Ibid.

Nakayama's product catalogue, "TRUSCO Orange Book," increased from four volumes to ten, while the number of products listed in the catalogue increased from 107,000 SKUs to 359,800 SKUs, and the number of manufacturers (suppliers) rose from 980 to 1,572. According to President Tetsuya Nakayama, it is the company's conviction that stronger inventory stocking capabilities contribute to stronger sales capabilities. The company holds a meeting for its suppliers, called the Tanabata Kai, once a year.

R&D

Trusco Nakayama believes that fully utilizing an IT system gives the company operational superiority over its competitors. The company has been aggressively investing in IT systems for about ten years. For example, the company eliminated the use of supplier invoices by automating the payment process. Now, product details are inspected at the time of delivery, and this activity automatically initiates the payment process. The company has been improving both its product search process and its order receiving process at its e-Commerce wholesale site, "TRUSCO Orange Book.Com." The company has adopted artificial intelligence (AI Orange Rescue) for in-house use. The company is working in-house to improve the precision of AI for image searches and product searches using natural and fuzzy language. This feature will eventually be made available to the company's customers as soon as all the necessary preparations have been completed.

Distribution

Trusco Nakayama attaches importance to the "Stock Hit Rate" (inventory items' percentage of total products ordered). The Stock Hit Rate was 89.9% at the end of September 2018. Over time, the company has been expanding its product lineup and strengthening its distribution function. Trusco Nakayama increased the number of distribution centers from 14 in 2008, to 22 in 2018. The company has also been investing in the automation of its distribution centers, and has introduced an automated warehouse system (specifically, AutoStore, a product of the Norwegian company Jakob Hatteland Computer AS). Its warehouse operations are much different from companies that use a "just-in-time" approach to minimize inventory.

Trusco Nakayama owns fleet of trucks and makes deliveries twice a day from 22 distribution centers to customers located within a one-hour drive. The trucks make dedicated runs on fixed delivery routes every day. The company operates satellite branches that are located within a two- or three-hour drive from one of its distribution centers. Inventory is transported from the distribution center to a satellite branch each night, on a fixed delivery route. The inventory is then transported from the satellite branch to the customer's site twice a day. The company has stock branches that are more than a three-hour drive from one of the company's distribution centers. Stock branches receive an inventory replenishment once a day. From stock branches, deliveries are made to customers twice a day. For customers who are not located within the network described above, the company has arranged for a route delivery service company to make deliveries once a day. About 80% of the customers are served by Trusco Nakayama's fixed-route delivery service.

Marketing

Trusco Nakayama invites leading e-Commerce sales agents to tour one of its distribution centers to let them know about its highly reliable quick delivery service. This interaction with e-Commerce sales agents often leads to new customer acquisition. Trusco Nakayama does not make sales calls on machinery tool dealers (the company's main customer segment), nor does the company require its sales staff to acquire a specified number of new customers. Usually, new customers in this segment will approach Trusco Nakayama, or one of the company's suppliers, and introduce themselves to the company.

Trusco Nakayama received about 50,000 inquiries (e.g., whether a particular product was in stock, price-related inquires, and inquiries about whether an estimate can be issued).

Human resource management

Trusco Nakayama has all its employees receive a 360-degree evaluation. One hundred fifty-five managers (as of the end of September 2018) anonymously evaluate all of the company's executives. The company periodically has staff members rotate jobs within their own department, and sometimes across departments. The company has developed various original training programs, customized for each layer of

management. These programs are taught by senior employees.

Trusco Nakayama does not use temporary staff. The company employs full-time and part-time workers. (Part-time workers are not the primary breadwinners of the family.) Of the company's 2,720 employees, 1,621 are full-timers, and 1,099 are part-timers (as of the end of September 2018). The company commits to hiring workers directly. Trusco Nakayama also employs nurses, who work at the company's offices, as well as childcare workers, who work in the nursery within each distribution center, and cooks, who work at company's recreational facilities. All the newly hired employees are assigned to a distribution center, where they work for 14 months. Trusco Nakayama publishes a booklet that features the photographs of the company's employees, and includes a comment from each person. This booklet, which is distributed in-house, helps employees get to know the other people in the company.

Since 2001, Trusco Nakayama has been introducing programs to help employees work for longer tenures within the company. For example, there is the "Yutori Jitan" system, which allows employees to shorten their working hours by up to three hours a day until their child has graduated from elementary school. In the case of individuals who must care for a sick, disabled, or elderly family member, they may take advantage of the shortened working hours for as long as necessary. This program was started in 2001. Another program, called "Happy Sunday Program," is for employees who are living away from home. The company pays the travel expenses for two hometown visits per month, covers their rent, and gives them an allowance. When employees return to work on Monday, there is a chance they will not be able to make it to the office in time for the start of their work day. (Even if they were to take the very first train departing from their home town, they still could not arrive in time. In such case, the company will allow a late arrival without any penalty, but only if prior notice is given.) This program was started in 2002. Trusco Nakayama has also extended the retirement age twice (once in 2012, and again in 2015). Since 2015, the retirement age for managers is 62, and for all other employees is 65. With the employment extension, employees can now work full time until the age of 70, and part time until the age of 75.

General management

Trusco Nakayama's financial management policy is to select fixed costs over variable costs. This means that the company owns warehouses and trucks, carries large inventory, and employs workers rather than use temporary staff. The company believes in taking ownership of assets, because it then becomes possible to make continuous improvements. The decision to take ownership and be responsible for running those operations is also motivated by the following considerations: (1) indirect materials have a thin profit margin; (2) sales are expected to be stable even in the worst times; and (3) the cost structure is such that high fixed costs will result in high returns once the sales volume exceeds a certain level.

Fit among Activities

Trusco Nakayama Corporation made four choices that are central to its competitive strategy: (1) Quick delivery; (2) low-cost delivery; (3) personnel management that fosters a good work environment for employees; and (4) limited services.

Quick delivery is supported by a broad product line and large inventory; a distribution system that is comprised of a distribution center and fixed delivery routes; and automated supply chain management. Low-cost delivery is enabled by the broad product line, a customer base, and investment in automated distribution centers. A low-cost delivery system enables shipments in small lots, and twice-daily deliveries. A good work environment contributes to: (1) the low attrition rate among employees, and supports their professional development; (2) the decentralized operation of distribution centers and branch offices in various parts of Japan; (3) the ability to serve customers in different segments; and (4) the development of private-brand products. "Limited services" refers to the company's decision to specialize in the wholesale of indirect materials. Consequently, there are: (1) no bills payable and bills receivable; (2) no sales activities focused solely on the domestic market; and (3) no cross-holding of shares. The company's specialization in the

wholesale of indirect materials enables investments in fixed-cost items, such as distribution centers, trucks, inventories, and employees. (Please refer to Trusco Nakayama Corporation's activity system map, which appears at the end of this report.)

Innovation that Enabled Strategy

- Trusco Nakayama's First Law of Inventory
"More inventory, more sales." Trusco Nakayama believes that quick product delivery is the best service it can provide. Many companies avoid holding slow-selling products in inventory. Trusco Nakayama, however, believes that if the products are in inventory, they will sell. The reason that products will sell is because customers value quick delivery. Because the items are shipped from inventory, quick delivery is possible.
- Trusco Nakayama's Second Law of Inventory
- "Focus on the Stock Hit Rate." Many companies focus on the inventory turnover rate. Instead, Trusco Nakayama focuses on how much of the order was shipped from inventory.
- Trusco Nakayama's Third Law of Inventory
- "Inventory provides the energy for growth." Many companies think of inventory as a cost. Trusco Nakayama thinks that a broad product lineup and huge inventory will help the company to earn the customers' trust, which in turn will contribute to its sales growth. Inventory is what enables Trusco Nakayama to demonstrate its reliability. Knowing Trusco Nakayama's strong commitment to inventory, customers can say with confidence, "Trusco has it."

Trade-offs

- Does not enter the retail segment. By not selling directly to the end users, Trusco Nakayama can avoid competing with its own customers. Moreover, the company can also expand its customer base, by not only attracting sales agents but also other wholesalers.
- Does not focus on increasing inventory turnover or reducing its inventory. Having a large inventory increases the cost of inventory management, as well as the risk of having bad inventory. However, having a large inventory enhances customer convenience, because the shipping of inventory stock makes possible shorter delivery lead time.
- Does not use bills payable or bills receivable. By not accepting bills payable, Trusco Nakayama can reduce exposure to bad loans resulting from customer insolvency. This enables both suppliers and customers to reduce their workload related to bill collections and troublesome receivables management. Trusco Nakayama pays by cash on the 10th of the following month.
- Does not expand its lineup of merchandise beyond tools for professional use (i.e., indirect materials). Trusco Nakayama has broadened the product lineup within the indirect materials category, further improving the benefit of one-stop shopping for customers.
- Does not conduct sales activities outside of Japan.
- Does not engage in the cross-holding of shares. To enhance fairness in the stock market, Trusco Nakayama encourages its employees to freely sell company shares obtained through the employee stock ownership plan.
- Does not rent distribution centers, branch offices, the headquarters building, or any major equipment. Trusco Nakayama's policy is to take ownership, and thereby ensure that employees will have a comfortable work environment.

- Does not hire temporary staff. Trusco Nakayama employs full-time and part-time workers. (Part-time workers are not the primary breadwinners in the family.) By facilitating the employees' professional development, the company supports its own growth.
- Does not depend on an independent service provider for its distribution function. Trusco Nakayama owns a fleet of trucks, and has developed its own distribution network. For high-density areas, the company makes deliveries twice a day from a distribution center on a fixed route. The company hires a route delivery service when delivering items to customers located outside of its fixed routes.
- Does not charge for returned inventory goods. Customers can settle their returns online.

Consistency of Strategy over Time

Trusco Nakayama was established under the name “Nakayama Kiko Shokai” in Osaka in 1959, and started out as a wholesaler of indirect materials, such as machinery tools. In 1963, the company began publishing an original catalogue, Nakayama Shoho. This catalogue is still being published now, but it was renamed, “TRUSCO Orange Book” in 2000.

The development of private brand products goes back to the company's very early years. Trusco Nakayama (named Nakayama Kiko Shokai at the time) was the last company to enter the indirect materials wholesale market. Nakayama Kiko Shokai saw an opportunity in peripheral professional-use products at a time when its competitors were focusing on tools. The company developed its first private brand product, called “Komyotan,” a powder for rust, corrosion and seizure prevention. The company packaged this product in smaller portions at a time when competitors were offering it in only one size, an 18 liter can.

Trusco Nakayama began developing its own distribution network and started making small-lot deliveries in its early years. In 1994, the company established its first distribution center in Kyushu. Since then, the company has strengthened its efforts to improve the logistics function. Trusco Nakayama installed a barcode inventory management system in its distribution centers in 2002. It introduced a logistics management system (Coconuts) in 2005. Trusco Nakayama commenced operation of its first large-scale distribution center, Planet East Kanto, in Matsudo, Chiba, in 2006. Since then, the company has been investing in large-scale distribution centers, and adding more products to its inventory, maintaining the view that more inventory will help to improve customer convenience.

Profitability

Trusco Nakayama Corporation's five-year averages for the return on invested capital (ROIC) and the return on sales (ROS) exceeded the industry average. (Profitability analysis was conducted by PwC Japan.)

Return on invested capital (ROIC) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
4.2%P	1.9%P	2.2%P	6.9%P	7.8%P	4.1%P

Inter quartile range (IQR) = 5.5 %P

Return on invested capital = Operating income / Average invested capital

Return on sales (ROS) (Unit=percentage point)

Difference from industry average					
5Yrs Avg.	2013	2014	2015	2016	2017
4.1%P	3.9%P	4.7%P	4.8%P	4.5%P	3.8%P

IQR = 2.1 %P

Return on sales = Operating income / Net sales

Activity System Map of Trusco Nakayama Corporation

