

## Value Creation

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# There Is No Smooth Road to Change.

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## Delayed full-scale reopening begins

In May of this year, COVID-19 was moved to Class 5 under the Infectious Diseases Control Law, which is equivalent to seasonal influenza. The department store industry has been the slowest to reopen among retailers, but it is finally on the road to a full-fledged recovery. With the resurgence of foot traffic, we expect economic activity to become increasingly normalized and vigorous.

In addition, the move toward a higher level of wage increases, which has not been seen in recent years, is expected to ensure that consumer sentiment will be positive. The Company has added a flat 10,000 yen per month to the monthly wages for fiscal 2023, under the name of “livelihood support subsidy.” Furthermore, given that Japan’s domestic personal financial assets, including residual COVID-19 savings, continue to exceed 2,000 trillion yen, it could be said that the sentiment is such that any single trigger, such as the provision of absolute asset value or irreplaceable experience value, would certainly have a positive effect on consumption.

The driving force behind our recovery process is spending by the wealthy class in department store

sales. During the current medium-term plan period, our first priority is to fully recover both BS and PL from the damage caused by the COVID-19 pandemic, and while we have been forced to narrow down our investments to some extent, the Department Store has focused on strengthening the luxury and watch categories. We also see a further expansion of our digital touch points beyond our expectations.

In particular, we have been able to encourage consumption among relatively young customers in their 20s to 40s, and the share of these customers in our gaisho sales has increased to nearly 30%. Furthermore, the recent rise in stock prices will continue to boost spending by the wealthy class as an asset effect.

Meanwhile, we are keeping a close watch on the prolonged inflationary situation. The rise in utilities expenses had a negative impact of 2.6 billion yen on operating profit in fiscal 2022, and we expect the same level of impact in fiscal 2023. At home, in addition to rising utilities expenses, there are also cases where prices for the same items such as food are repeatedly raised several times. Despite the rare and unprecedented increase in wages in recent years, it is undeniable that real wages have been slow to rise.

However, we do not overestimate the current situation.

Rather, this is an opportunity to “move up a gear for change.”

Even taking into account such uncertainties, I am certain that the reopening effect will be sustained to a certain extent, considering the accelerating recovery of domestic foot traffic and the expected demand from inbound customers from mainland China, given that the industry has lagged behind.

However, we try not to overestimate the current situation. Rather, we believe that we are now at a major turning point and that this is an opportunity to “move up a gear for change.” The essential challenges that the Department Store has faced up to now have not been solved suddenly. I still hold the belief that a bright future cannot be envisioned as an extension of the past.

## Strengthen stores based on capital profitability

To achieve portfolio transformation, we are working to enhance business management by adopting ROIC

by business with an awareness of cost of capital. We believe that pursuing higher ROIC by business from the perspective of return on invested capital is the way to evolve business management. Another key point is that it is an easy-to-understand indicator of the link between business profitability improvement and employee efforts.

The Department Store Business has the highest ROIC in our current business portfolio, but it is clear that concentrating investment in this area is not the direction we should take from a medium- to long-term perspective. On the other hand, we also believe that it is not impossible to achieve a higher ROIC with the various reform initiatives the Department Store is currently pursuing. We believe that even if growth by increasing the number of stores is difficult, there is plenty of room for evolution by reforming the business model. The Department Store is already able to track BS by store, and we hope to take advantage of the



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adoption of ROIC by business to further improve capital profitability.

We believe that our retail business is predicated on the strength of our real stores, even when promoting digitalization. To make our stores stronger, we must refine our content, services, store environment, and highly efficient operations. To this end, we believe that we should be more aggressive in investing in stores where we can expect a solid return, while assessing the capital profitability of each store. The adoption of ROIC has also led to a change in mindset that emphasizes such an investment-return relationship.

In recent years, the reconstruction of the Shinsaibashi store required a large amount of cash, so it is undeniable that investment in other key stores has been somewhat restrained. Specifically, we believe that department stores such as the Nagoya, Sapporo, and Kobe stores have the potential to earn substantial cash if appropriate investments are made.

In order for ROIC management to take root at the group level, it is extremely important that the field staff understand the importance of ROIC management. We would like to keep in mind that we should proceed from the same perspective as the operating companies, rather than from the “top-down”

perspective of the holding company.

Last fiscal year was positioned as the phase to spread understanding, and we held study sessions and briefings at each of our operating companies, as well as discussions on KPIs, how to operate the KPI tree, etc. In this fiscal 2023, we will conduct preliminary operations at some of our department stores and PARCO stores. We will also chart the path toward setting and achieving the financial targets of the next medium-term plan, centered on ROIC, with the aim of starting full-scale operations in fiscal 2024.

While the focus is on improving PBR of less than one in the capital market, we are confident that the adoption of ROIC by business will enable us to achieve management sophistication and increase the ROIC spread for each business, which will also lead to higher PBR.

However, the fundamental reason why our PBR is currently around one is that we do not have a clear path to medium- to long-term growth. It is also essential to aggressively make the necessary investments to deepen and explore for growth. Therefore, I believe that we need to more clearly show what kind of future the changes we are working on now will lead to.

Only “people” can bring about innovation.

Therefore, both young people and outsiders are actively involved.

### Turn diversity into innovation

Innovation is essential to survive in these highly uncertain times. Innovation is created from the combination of existing knowledge, and only “people” can bring about that innovation. Therefore, it is obvious that the more diverse the knowledge is, the more choices we have. In terms of diversity, while promoting more women is a must, we place greater emphasis on the “diversity of thinking” that arises from people who are diverse in terms of age, background, and others.

I think one of the key points is to include people who have grown up in the culture of Parco, which is different from that of the Department Store. Parco became a wholly owned subsidiary in March 2020, but in the first year after that, its human resources were not fully incorporated into the Group, and it was

almost a stand-alone organization.

Therefore, as we move forward with the current medium-term plan, we have made a conscious effort to assign people from Parco to key posts, primarily in the holding company. As we worked together in earnest, it became clear that there are many people with various ideas and perspectives that are different from those from the Department Store. We are convinced that incorporating and integrating this knowledge into the Group will be one of our major weapons in the future.

In addition, we are actively promoting mid-career hiring from outside, particularly in management strategy, finance, and legal affairs. I expect that the percentage of mid-career hires at the holding company will reach up to 50% in the near future. It is true that it is becoming more and more difficult to hire digital human resources. Needless to say, digital technology



is an indispensable factor in terms of productivity improvement. For this reason, we launched the Digital Human Resource Development Plan last fall, with a digital specialist hired from outside as a leader. We have set a challenging goal of developing 1,000 digital human resources by 2030, and we are actively working toward this goal.

Utilizing diverse ideas and perspectives is not limited to bringing in human resources themselves. In other words, I feel it is important to create opportunities for collaboration with outside parties, especially for young people. The CVC fund we established last fall aims to fulfill just such a role. Young people are taking the lead in seeking collaboration with startups and working to create synergies through innovation, involving employees of operating companies. Five investments have already been made, and we are looking forward to seeing what output will be shown from them.

I think diversity is really progressing at the holding company. However, unfortunately at Daimaru Matsuzakaya Department Stores and Parco, we have to say that there is still a long way to go. We would like to make a strong effort to promote innovation in this area.

### Customer creation in the “new era”

The Department Store Business is supported by regular customers of relatively older age groups. On the one hand, this means that we are aging together with our customers, and our challenge is how to develop new customers, especially younger customers.

As I mentioned earlier, the Department Store’s gaisho sales, which represent spending by affluent customers, are growing as the share of purchases by customers in their 20s to 40s who are relatively young as the Department Store’s customers is expanding after the COVID-19 pandemic. This means that robust purchases continue, centered on content such as luxury items and contemporary art. I feel that what is

important is the content, the digitalization of touch points, and the real store space.

An even stronger indication of this is the movement of GINZA SIX, which is increasing its presence as a luxury mall. GINZA SIX opened in 2017 with the choice “not to operate as a department store.” Later, in 2021, many of the shops were due for renewal, so a major renovation was undertaken, including tenant replacement. Although there were some negative views because it was right in the middle of COVID-19, it continues to make greater-than-expected strides, recording its highest monthly sales ever in December of last year. Of particular note is that customers in their 20s and 30s account for half of its sales. We see potential in this fact for the future of the Group. I feel that there is still much more that we can do as a retailer to create new customers.

To broaden the perspective of customer creation a bit more, how the Group can access the Millennial Generation and Generation Z is a major issue as the Group aims for medium- to long-term growth. I make a conscious effort to talk with people of these generations, and I find that their lifestyles and values are clearly different from those of us, the Showa generation, in ways that cannot be explained simply by the demographic factor of age. Both of them are digital natives, and Generation Z in particular is said to be social natives, so we believe that a completely different approach is needed.

As part of these efforts, we decided to enter the esports business by acquiring a 50.8% stake in XENOS Co., Ltd., which operates the esports team SCARZ, in October last year, making it a subsidiary. Esports is characterized by a high level of interest among the younger generation, especially those in their teens to 30s, including Generation Z. It has a high affinity with businesses utilizing digital technologies, such as metaverse and NFT, and various business developments are expected. While steadily realizing the real-world effect of attracting customers, such as

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holding events at the Group's facilities, we believe that expanding our business to the digital side will lead to the acceleration of strategy execution.

We will acquire leading content and make our real commercial facilities stronger. In order to cultivate new markets, the enhancement of content is the cornerstone. I am convinced that esports will be an important part of this process.

As another important factor, in terms of organizing customers, I think it is essential to devise an approach that takes into account the changing times. Today's consumer behavior is characterized by the presence of a narrow and deep market, against a backdrop of diversified values and fragmented customer preferences. I believe that key words such as infatuation and fervor also represent such a situation. In other words, we are in an era where the connection between like-minded people is emphasized, which is truly the era of community, and we are also considering utilizing the information obtained from the interaction of like-minded people there in commerce. We are already making preparations, including investment in companies with such management capabilities and know-how, and hope to link this to the creation of new customers.

### “Community” as a growth driver

As of March 1 this year, the Developer Business that had been handled by Parco was split off from Parco and started anew as an independent company called J. Front City Development. At the same time, the CRE Strategy Unit was newly established in the holding company to optimize the Developer Business from the Group's perspective and maximize value creation. And I was appointed as the head of this unit concurrently.

Seven cities designated as key areas for the new

company's strategic promotion (Tokyo, Sapporo, Nagoya, Osaka, Kyoto, Kobe, and Hakata) are home to Daimaru or Matsuzakaya department stores or PARCO stores. In other words, we believe that our unique feature and strength is that we own real estate in major cities that can be developed, including the areas surrounding our stores. Projects are already underway in the Sakae area in Nagoya and the Shinsaibashi area in Osaka, both of which are scheduled for completion in 2026. Furthermore, in the Tenjin area in Fukuoka, the Tenjin Big Bang has finally begun to move forward, and we have started to study the possibility of moving forward with a large-scale development project. Also for other key areas, we plan to show concrete pipelines in due course. We hope that you will look forward to this as one direction for our portfolio transformation with a new growth driver.

In order to expand the Developer Business, we will work on non-commercial businesses such as hotels, offices, and residences to diversify earnings as the Developer Business, but the significance for us to operate the Developer Business lies in our strength in commerce. However, we believe that we can provide unique value to society by creating a “new type of retail” that combines the strengths of the Department Store and Parco, rather than limiting ourselves to existing retailers such as the Department Store and Parco. I believe that our ability to do so is what makes the Group unique.

In this way, our major value of existence is our commitment to coexistence with local communities, based on our nationwide department stores and PARCO stores. Rather than viewing the stores in the community as “dots,” we view them as “areas” involving the community, and link them to various actions from the perspective of creating and providing the value sought

by the local community.

One example of a unique local initiative that I feel has potential is the Kyushu Tankentai (literally Kyushu expedition team), which was started at Hakata Daimaru. This project aims to revitalize the entire region by having our department store employees visit cities in Kyushu and Okinawa and, in cooperation with the local governments, uncover attractive people, tangible goods, intangible goods, and even culture in those cities that are not yet widely known, and introduce them to the public through us. As of July 2023, we have been

certified as an information dissemination ambassador by 112 cities in the Kyushu and Okinawa areas.

In addition, Parco and CAMPFIRE, Inc. jointly operate the crowdfunding BOOSTER, and Daimaru, Matsuzakaya, and PARCO stores collaborate with the local communities to create an evolved regional revitalization system together with local craftsmen and companies.

Unearth and polish local gemstones. In addition to the expansion of high-quality global content, such efforts may lead to a global strategy that includes inbound sales in the future.

As we are in the middle of the supply chain,  
we will do our part for sustainability.

### Creating shared value is the practice of our corporate credo

I am reminded once again that our corporate credo, “Service before Profit,” or “Abjure All Evils and Practice All Good,” is an idea that truly fits the times we live in today. Those who give priority to service over profit will prosper. Do no evil, but do good. I believe that they are simple expressions of what it means to contribute to society.

Contributing to society means continuing to provide our unique value to society, which in turn leads to economic value. We recognize that this is CSV (Creating Shared Value) itself.

A bird's-eye view of our supply chain reminds us that we are in the middle, connecting our suppliers to consumers. In other words, we are able to reach out to each of our suppliers and customers in a variety of ways, and I think it is fair to say that we exist to play this role in society.

We recognize that one of the ways to reduce greenhouse gas emissions toward a decarbonized society is to address Scope 3, which is indirect emissions other than Scope 1 and Scope 2. Scope 3 initiatives cannot be realized without the cooperation of our suppliers. More than 80% of our Scope 3 emissions are from Daimaru Matsuzakaya Department Stores, but by informing our suppliers of our efforts toward a decarbonized society through briefing sessions, we demonstrate our resolve and ask for their cooperation in making their emissions visible.

In addition, when we think about what we can do in our own way while leveraging our strengths to balance sustainability for both society and our corporation, I feel certain that the direction we should take is to a little more strengthen our efforts toward a circular economy.

Launched in March 2021 as a subscription business, AnotherADdress has been strongly favored by customers based on the belief that clothes are not disposable. We are developing a business model that goes beyond fashion rentals, partnering with a 3PL company, a delivery company, a cleaning company, and a recycling company that are promoting their own sustainable initiatives.

In addition, the ECOFF program to collect customers' unwanted clothing and accessories has been gaining recognition from customers every year since its launch in 2016, and in fiscal 2022, 367 tons were collected, with a record number of participants.

Customers' awareness and values have clearly changed, and I feel that they are becoming more and more conscious of sustainability. This tendency is especially strong among the younger generation.

We have been in existence for 300 or 400 years because we have been able to quickly identify and respond to the changes of the times and our customers. However, discontinuous thinking is indispensable for rapid changes like now. Therefore, we are prepared that the road to change will not be smooth. We will continue to create indispensable value for society by carefully assessing what we can do and what only we can do.

