

A full-length portrait of Yamamoto Ryoichi, a middle-aged man with glasses, wearing a dark blue suit, white shirt, and dark tie. He is standing in a modern office hallway with wood-paneled walls and a carpeted floor. He has his arms crossed and is smiling at the camera. The hallway recedes into the background with recessed ceiling lights.

YAMAMOTO Ryoichi

Director, President and
Representative Executive Officer

We Will Continue to Challenge Changes and Aim for Sustainable Value Creation.

The “Reiwa” era has begun and expectations for the new era are raised. The current fiscal year is the halfway point of the five-year Medium-term Business Plan of J. Front Retailing (the “Company”), which started in fiscal year 2017 with the new Group Vision “Create and Bring to Life ‘New Happiness.’” At the same time, I think it marks a turning point for J. Front Retailing Group (the “Group”) to grow dramatically.

The growth of the Real Estate Business, which was newly created as an independent segment, as the result of our efforts during two years after the Medium-term Business Plan was launched, is a steady first step to change our business portfolio. In addition, governance reform and B/S-based management have made progress. Thus I think our foundations of business have been strengthened steadily. On the other hand, in terms of production of tangible results of growth strategy, I cannot say its progress during these two years has reached the management’s satisfactory level.

Currently in the business environment surrounding the Company, uncertainty and complexity are increasing. The global economy seems to be “at a turning point” and uncertainty about the future has been heightened since the end of last year. Many Japanese companies started to be impacted in various ways. Recently “uncommon” weather attributed to global warming trend occurs every year and is “becoming common.” And consumption tax hike is planned in October. In light of trends after consumption tax hikes in the past, I think increasingly polarized consumption and budget-minded consumer spending are unavoidable. Besides, transformation of social structure by digitalization and values shift from “possessing” to “sharing” will continue to progress in an accelerated manner.

Such uncertainty can be restated as risk. And we have to note that risk has both positive (opportunity) and negative (threat) aspects. If we can actively take positive risks while hedging negative risks appropriately, it may lead to sustainable growth. Therefore, we will

clarify the priority order of our initiatives against uncertainty and reflect them in our management strategy.

In the current fiscal year 2019, two ongoing big projects, which symbolize the turning point of the Group, will be completed. Specifically, the “new main building of the Daimaru Shinsaibashi store” and “new Shibuya Parco” are planned to open on September 20 and in late November, respectively. In the current era when e-commerce and sharing economy are rapidly spreading, we are asked “what is the meaning of the existence of real stores.” With these two projects, we would like to show the direction of our unique new retail business model leading to the future. They are bold challenges to changing times. However, I believe such ability to respond to changes is the DNA and strength of the Group with histories of 300 and 400 years of Daimaru and Matsuzakaya, which are the predecessors of the Company, respectively, and leads to sustainable management through the implementation of our corporate credo.

I think a sustainable society can be built if individual companies as public entities of society clarify the priority order of issues to be addressed through dialogue with stakeholders and play their roles. To this end, last year the Company identified five materiality issues after seeking opinions from stakeholders and discussing at the Board of Directors meetings. And we set long-term goals and announced them and brought our initiatives into full swing. In the current fiscal year, we will strive to manage the progress thoroughly and resolve issues promptly by forming a Sustainability Committee to further strengthen promotion systems.

Toward real growth beyond stakeholders’ expectations, we, at the turning point of the Group, will step up a gear to promote the Group’s business structural changes and strive to increase corporate value over the medium to long term while creating both economic value and social value. And at the same time, we will contribute to creating a sustainable society.

June 2019



**“Create changes.
Carry out this one thing
simply and honestly.”**

Response to constant changes

We are a holding company established in September 2007 through the management integration of Daimaru and Matsuzakaya, both of which are department store chains. Daimaru and Matsuzakaya, which have long histories of 300 and 400 years, respectively, continue to practice sustainable management while properly responding to changes in customers and society.

Why could the Company maintain management for such a long time? I think it is because their philosophy has been persistently kept at the core of management despite significant changes of the times and all management activities have been integrated under this philosophy.

Our corporate credo “Service before Profit” is quoted from a passage written by Xunzi, one of the founders of Confucianism in China. Service before Profit means those who give priority to service over profit will prosper. All management activities have been

integrated under this credo.

The word “Service” in the credo means social justice, which describes attitudes to pursue the right way in business and contribution to the public. It can be rephrased as a “customer first principle” and “contribution to society,” and that is a pursuit of both social and economic values in consideration of current ESG issues. In other words, they are consistent with the idea of Creating Shared Value (CSV).

When looking at the history of the Group, we can see that it is a repetitive cycle of crises and innovations. The biggest crises that we have faced so far are the “Rebellion of Oshio Heihachiro” in 1837 when our predecessors escaped burning and the financial crisis around 1907 when our business gradually worsened by increased bad debts after the collapse of the Edo Shogunate. On the other hand, the biggest innovation seems to occur about 100 years ago when our business model was transformed from “*zauri* or bringing products at customer’s request to showcasing,” in other words, from a kimono fabric

dealer to a department store operator. In the long history of 300 or 400 years, our predecessors were hit by many crises. We can say that it is a miracle in a sense that the Group exists today thanks to their relentless efforts to weather these crises and reform and innovate themselves. We can tell from this history that a crisis occurs whenever we become arrogant, fail to respond to changes of the times and society, and stop innovating ourselves.

Stated differently, unchanged values or philosophy at the core of our management activities made it possible to respond to changes so far and this spirit continues to exist in our current Group Vision.

Business model needs to be changed

Increasing obsolescence of business models with changes of the times is unavoidable. The business model of a department store (*hyakkaten* in Japanese, which literally means a store selling hundreds of items) was created instead of a kimono fabric dealer about 100 years ago. As you may know, department stores do not deal in “hundreds of items” partly due to the rise of category killers. Department stores changed their product mix to the one overly dependent on clothes, in particular, women’s clothes against the backdrop of the DC brand boom in the 1980s from a full line ranging from clothes to furniture, home appliances and food, which is the origin of the word *hyakkaten*. At the same time, their main business structure changed from selling after purchase called *kaitori* to purchase without inventory called *shoka shiire*, which accounted for around 80%. And the main business shifted from merchandising to marketing or brand assortment. It was then that department store sales peaked.

In the meantime, consumption in Japan has been changing rapidly since then. According to the Family Income and Expenditure Survey by the Ministry of Internal Affairs and Communication, the percentage of expenditure on clothing and footwear decreased to 3.8% in 2018, almost a half of 7.3% in 1991. However, department stores could not get out of former successful experience and too much floor area has been allocated to women’s clothes. It increased gap in tastes between customers and department stores. When sales are increasing year after year, the business model centered on *shoka shiire* and women’s clothes is low risk and can be expected to increase profit by ensuring that costs are thoroughly managed. In the current mature market, however, economic sensitivity becomes stronger and the risk increases accordingly. One of our strengths is large assets in prime urban locations. Under such risk, however, we fail to extract enough profits from them in terms of

asset efficiency, which is recognized as a problem. In order to aim to achieve sustainable growth while generating revenue that matches the asset value, it has become inevitable to closely investigate the market of each area and redefine what our business model should be.

To this end, we have decided to study the two major directions of our new business model. One is the option “not to operate a department store,” which means we 100% transform ourselves to a real estate rental business. Specifically, it includes Ginza Six, which was created by developing the two blocks including the former site of the Matsuzakaya Ginza store as one, and Ueno Frontier Tower, which was created by rebuilding the south wing of the Matsuzakaya Ueno store. Both opened in 2017 and contribute to the growth of the Real Estate Business segment by generating stable revenue as expected. The other is the establishment of a hybrid model with an optimally balanced mix of the advantages of real estate rental business and the advantages of *kaitori* and *shoka shiire* business under the department store brand. Its concrete example is the new main building of the Daimaru Shinsaibashi store, which is planned to open on September 20 this year. With the concept of “Delight the World. Shinsaibashi, Adored by the World,” particularly on the 1st to 3rd floors, luxury items and cosmetics that have growth potential will be significantly expanded as the *kaitori* and *shoka shiire* business by “global standards”. The 4th to 10th floors and basement floors, which account for approximately 65% of total sales floor area, will be operated under fixed-term lease. Without adhering to the floor layout according to traditional stereotypical merchandise classification, we will consciously incorporate the elements of experience-based consumption. Since it will have a completely different personnel structure from traditional department stores, an unprecedented low-cost operation model will be created. In spite of such great changes in the business model, customers will be able to enjoy shopping completely seamlessly between *kaitori* and *shoka shiire* floors and fixed-term lease floors. I hope you will look forward to the scalable and highly profitable new model, which will show one future direction of department stores.

Challenge of changing business portfolio

We could say department stores have much room for profit growth by these changes in the business model. However, I recognize we need to change the Group’s business structure that is overly dependent on the Department Store Business in order to aim for more sustainable growth. The Company has strived to become a multifaceted retailer since its inception so

that we can expand into retail business other than the Department Store Business. In 2011, we converted StylingLife Holdings Inc., which operates general merchandise shops named Plaza, into an equity method associate. In 2012, Parco Co., Ltd. was converted into a consolidated subsidiary. By implementing these initiatives, we have steadily spread our retail wings. The range of our retail business has been thus expanded steadily. However, consumption is shifting from goods to experiences and services. It is hard to avoid thinking it will be difficult to achieve dramatic growth that meet the expectations of stakeholders if we depend on business centered on physical stores. Therefore, we will take one step away from our past approach as a multifaceted retailer to act as a “Multi Service Retailer,” thereby expanding our business domain to encompass endeavors in new fields extending beyond the retail industry framework. Meanwhile, we will actively reshuffle our portfolio of businesses by accelerating the identification of unprofitable business fields and other efforts. The major theme of the current Medium-term Business Plan is the expansion of the newly created Real Estate Business segment and building of the foundation of the Credit and Finance Business for medium- to long-term growth. As for the Real Estate Business, Ginza Six and Ueno Frontier Tower, both of which opened in 2017 by transforming the business model of department store assets, perform well as expected and we expect share of its operating profit to increase to around 12% from 0.8% before the current Medium-term Business Plan was launched. The Credit and Finance Business invited a person who accumulated experience in card companies and a mobile payment company from outside the Group as

its top management and tackles structural reforms to achieve significant growth in the period of the next Medium-term Business Plan and beyond. With regard to respective portfolios of the Department Store Business and the Parco Business, we are considering streamlining their stores, mainly rural and suburban stores, which have bleak prospects, by converting their formats or reducing rental area, or closing their doors if it is difficult to improve even with these efforts. Under the current Medium-term Business Plan, we have already decided to close the Daimaru Yamashina store, Otsu Parco, Chiba Parco, Utsunomiya Parco and Kumamoto Parco. We will identify the commercial environment where each store is located and clarify our direction to pursue optimal portfolio.

Improve and use the value of information

In the current “era of 100-year life,” lifetime value of each individual is expanding. Approximately 300 million customers visit our department stores and Parco’s physical stores every year. In such a situation, we have many direct customer touch points through the provision of various products and services, which is of great advantage to the Group. It is needless to say that the “value of information” gained through these customer touch points will increasingly enhance.

Individual companies such as the department store chain and Parco in the Group have their own good customer assets. For example, however, the data currently accumulated by department stores are mainly customer profiles and purchasing information gained through ID cards such as our private label credit cards. The Group does not centralize such information and do not have in place an infrastructure to extract enough

true value from our customer assets as “information.” Therefore, we are building a new customer base called the “Lifetime Service Hub” to create a system for strengthening “lifetime engagement with customers.” We will integrate and centralize the data base of good customers held by the Group and strengthen our “data economy” initiative using ICT such as AI and apps.

As the process of this initiative, in May this year, all Daimaru and Matsuzakaya stores released a “mobile app” that gives incentives according to the purchase amount. By using this app, we will identify customers and greatly expand our data base through department stores without depending on our private



label cards as we did before. In the next phase, we will use chat group-wide to improve the quality and quantity of customer information through accumulation of conversation and purchase history data. By adding the demonstration tests of AI analysis to upgraded data base, we will expand opportunities to provide optimal products and services, and furthermore, launch new businesses to create synergy among companies in the Group. I think medium- to long-term corporate value will vary according to the “quality of available information.”

Exceeding cost of capital is a must

We are committed to achieving an ROE of at least 8%, which is the goal for the final year of the current Medium-term Business Plan (FY2021). At the same time, we disclose the range of cost of shareholders' equity recognized by the Company. If we set an ROE target, it should exceed cost of capital and the management should recognize it to implement initiatives. Since historically we have made a living by operating department stores while holding large assets in prime urban locations, we have kept ourselves within the structure where “it cannot be helped that it is difficult to increase ROE.” However, it is natural for investors to expect return above cost of shareholders' equity. To be honest, it is undeniable that the Company lacked awareness of such cost of capital. Regrettably, even the management did not share the concept of cost of capital, let alone its amount.

This is why we have decided to disclose the current cost of capital recognized by the Company on the assumption that we aim to achieve an ROE of 8% or more. Since economic sensitivity is extremely strong in the department store sector of the stock market, cost of capital tends to become a little higher. In order for the Group with the Department Store Business at its core to achieve an ROE of 8% or more, it needs to reduce cost of capital as well as further increasing profit levels. As its process, we began considering reducing cost of capital by not only increasing profit levels by implementing growth strategy but also changing our business portfolio.

Concerning what I said now, the important point for the Group to realize ROE of at least 8% is how the Department Store Business at the core of the Group, which has large assets, will improve asset efficiency. To this end, we introduced a store level B/S to the Department Store Business to improve asset efficiency in each store. ROA of each store is broken down into indicators as a tree, which led to on-site improvement actions. ROA is one of the components of ROE. In order to achieve an ROE of 8% or more group-wide, each business sets an ROA target. Furthermore, for



example, in the Department Store Business, it is broken down into store level ROA as a target, which is also used to evaluate a store manager. We are highly recognized by investors that it is revolutionary for a department store to draw up a store level B/S. I expect we will have deeper dialogue concerning asset efficiency as well as profitability at store level.

Contribution to creating a sustainable society

The Company identified materiality issues that contribute to realizing “sustainable growth of company and society” and a “sustainable society” while clarifying the relationship between business activities and social issues.

Specifically, firstly, we selected 25 candidate materiality issues from the perspective of the environmental and social issues that are meaningful for us to address and can produce results and the issues we can tackle using our core businesses. Secondly, we conducted a written survey of 4,250 stakeholders on these 25 issues to secure objectivity and diversity. And based on the results of the survey in which the GRI Standards, the assessment items of ISO 26000 and SRI, and SDGs are reflected and after internal discussions at the Management Meetings and others, we developed a materiality map. In the process of discussions, we incorporated the perspectives of growth potential, profitability and the Company's uniqueness and discussed in view of the importance of social issues rather than ease in addressing them to identify materiality issues. And finally, we narrowed down the list of materiality issues to and formally determined five issues including “contribution to a low-carbon society,” “management of the entire supply chain,” “coexistence with local communities,” “promotion of diversity” and “realization of work-life balance” at the Board of Directors meetings. At the same time, we set long-term goals to be achieved and formulated an action plan.



The greatest importance is placed on “contribution to a low-carbon society” among them. Not only external factors such as adoption of the Paris Agreement and SDGs but also unusual weather and natural disasters that have occurred frequently recently in Japan and abroad actually affect our business activities. In view of the significance of negative risks from a long-term perspective, I cannot think it is good for us to stand back and do nothing or rely on others. To give an example, the head office building of Daimaru Matsuzakaya Department Stores already converted to 100% renewable energy in March this year. And the new main building of the Daimaru Shinsaibashi store and new Shibuya Parco, both of which are planned to open this fall, will become model stores for use of 100% renewable energy. As for reduction of CO₂ emissions, it is extremely important for the Company to reach out to the entire supply chain. It is a so-called “scope 3” initiative. Firstly, based on various policies concerning supply chain management including the Principles for Action for Suppliers formulated recently, we will share purposes and goals by disseminating them to and educating employees and providing briefings to suppliers. In the next phase, we will evaluate and select suppliers, and if needed, we will audit, monitor and feed back. By continuing them simply and honestly, we would like to produce tangible results.

“Coexistence with local communities” can be said to be the very core business of the Company. We promote the “Urban Dominant strategy” as the growth strategy of the current Medium-term Business Plan. It is aimed at growing with local communities with stores including department stores at its core. I think a community is a kind of ecosystem. That is to say, its large components and small components are all mutually connected to create the unique appeal of the area. Conversely, if our store works hard alone but part of the community is left weakened, the entire community will gradually run out of energy. Our

initiative to attract shops to the areas around our department stores and develop shops in these areas, which started from the Daimaru Kobe store in the late 1980s, is the root of the Urban Dominant strategy and contributes to increasing the appeal of the communities, which spreads from “points” to “areas.” As a matter of course, we cannot promote such initiative in all areas. We focus on the areas where the Group’s flagship stores are presently located. By further developing and expanding know-how accumulated through the development of shops around the Kobe store, in the Shinsaibashi area, we would like to play our own role, which is indispensable in the area, to create the “Shinsaibashi area adored by the world” based on the main building of the Daimaru Shinsaibashi store, which will open this fall.

Once mindset changes, work styles will change

I said earlier that a community is a kind of ecosystem and I think entities that constitute a community are living things. This is because they will rapidly degenerate, be selected and cease to exist unless they always evolve in response to changes in the external environment. One of the key roles of the management is to instill healthy risk awareness in the entire company and to always respond quickly to changes in the market and customers. To this end, I, as a managerial person, would like to clarify our vision and continue to show employees the course the Company should take and new goals. In order to realize that permanently, firstly, we will change employees’ mindset. Secondly, we will change the structures and systems of jobs. And we will clarify goals. By doing this, their work styles will change. We will evaluate their performance fairly and reflect it in their treatment. Furthermore, we will educate employees toward higher goals. I believe the constant repetition of this process is the only way to lead our reform to success.

At the same time as the Vision “Create and Bring to Life ‘New Happiness’” was developed, we also showed the JFR Way, which sets forth the employee action guidelines: “Create the future,” “Try without fear of failure,” “Introduce new ideas,” “Act for yourself,” and “Be sensible and honest.” Among them, it may have been unexpectedly difficult to “try without fear of failure.” It is important for the Company to encourage employees with the Company’s supportive programs and systems to change their mindset. One example is a new personnel program named the “Challenge Card.” We help individual employees and teams realize their ideas and inspirations. It is based on the assumption that an employee who takes on a challenge will receive extra points in evaluation. A

thought that “the way not to fail is to do nothing” should not happen. By clearly stating that we will positively evaluate the challenge to take concrete action even though it results in failure, their attitudes toward their jobs have changed remarkably. The number of the Challenge Cards has reached as many as 6,700 in a year and the number of employees who actively try to engage in interactions beyond individual divisions and companies is appreciably increasing. I think the spread of these changes in the mindset of individual employees will result in changes in a corporate culture and work styles, which will lead to major corporate changes. As a matter of course, however, managerial persons are not evaluated only for the process such as challenges and efforts. Needless to say, management is practice and only results matter.

Develop managerial talents

Three years have passed since we launched governance reform, mainly the reform of the Board of Directors. What I see through our initiatives is that strengthening of the Board of Directors and strengthening of managerial talents are inseparable. That is to say, we cannot activate the Board of Directors without strengthening managerial talents. In other words, the key is “people” after all. Investors may check the presence of vision and strategy with outlook for where the Group will go five and ten years from now and the presence of human resources who can accomplish them to make an investment decision. In that sense, I think strengthening of managerial talents is important. In my opinion, President should not have the exclusive power to shuffle personnel. Therefore, we created a Human Resources and Remuneration Committee to deliberate. After transition to a Company with Three Committees (Nomination, Audit and Remuneration Committees), the Committee was taken over by the Nomination Committee to clarify the process of appointment and secure transparency. For appointment and removal, we combine internal evaluation with the results of personnel evaluation by a third-party organization to ensure highly objective discussion. We rely on the Nomination Committee to determine not only the validity of the process of appointment but also appointment and removal of individual Directors and Executive Officers of J. Front Retailing and major operating companies.

In terms of leadership, it is not too much to say that business management depends on top management. And I think a succession plan for President as a chief executive officer is the most important strategic decision making. A succession plan for top management requires assumptions for five and ten years ahead as

well as an emergency plan for contingencies. We prioritize candidates and discuss since we voluntarily created a Human Resources and Remuneration Committee. Before that, I cast about only in my head. Currently we openly discuss and sometimes internal evaluation is different from evaluation by outside officers. I believe we take a larger view and make the best decision though we sometimes get into an argument of whether individual candidates are qualified for President or officers.

The removal of President is determined by the Board of Directors after the Nomination Committee discusses and resolves based on the status of results achieved by successor candidates who are selected under the succession plan resolved by the Nomination Committee as well as the goals set and expected and actual results. Outside Directors comprise a majority of the Nomination Committee and Outside Director also chairs the Committee. Therefore, I recognize it is highly objective and transparent. In the meantime, I think I can manage the Company with a sense of tension under such strict governance.

The management itself needs to take the initiative in transformation without being tied to successful experiences and change the mindset and actions of employees in order to transform ourselves to the Group that enables discontinuous growth. In the process of changing the Company significantly, we will make every possible effort with tenacity to produce tangible results to increase corporate value over the medium to long term beyond stakeholders’ expectations.

