Unprecedented COVID-19 crisis

“Service before Profit” – Those who give priority to service over profit will prosper. This Corporate Credo is the cornerstone of the Group that has survived for 300 and 400 years and I think it fits with the current times. Returning to this philosophy and practicing it is CSV itself, which produces both social value and economic value, and by doing so, I think we can keep up with the trends of ESG and SDGs. It is true that there are many unforeseeable things amid the COVID-19 crisis. However, I realize that this Corporate Credo is the basis on which we act when thinking of what we should value the most now.

In the current situation called the fight against the invisible enemy, what I thought first was ensuring the safety and security of customers and workers including those from suppliers and the employment of employees and survival as a company. Soon after the first person infected with COVID-19 was found in Japan in the middle of January, we took thorough measures to prevent infection by placing alcohol sanitizers in our stores and offices and allowing workers to wear masks. In February, we set up an emergency headquarters in the Company, and at the same time, I also asked each company in the Group to set up such headquarters. The core business of the Group has existed by creating commercial space, attracting customers from wide areas, and thereby “creating close contact.” And it just became a risk. When March began, our department stores had temporary holidays and reduced business hours. In addition, we cancelled large events such as regional product fairs, which attract many

“Let Go of Past Successes and Draw out Solutions to Coexist with COVID-19.”

Top interview
customers. Parco also reduced business hours and the events that might cause close contact were changed, postponed or cancelled. And in April, a state of emergency was declared and almost all stores were forced to close. The Group whose main business is the operation of conveniently located real stores has faced an unprecedented and unforeseeable crisis.

Therefore, we drew up three scenarios including a "standard scenario," a "risk scenario" and the "worst scenario" according to how long our stores will close affected by the COVID-19 crisis and considered the measures to be taken. For the worst scenario, we assumed that the declared state of emergency will continue until August. Seeing the situation changing every moment, particularly in terms of funding, we ensured cash reserves promptly by issuing commercial paper and increasing the commitment line limit.

In June, we could reopen stores finally. However, as infection risk was not eliminated completely, we could not operate stores in the same way as before closing. We placed thermographic monitors and sanitizers at the entrances to prevent anyone that has a fever or does not wear a mask from entering the stores. In stores, workers wear face shields and masks are given. And also in staff canteens, lounges and locker rooms, which are hidden from customer view, we take every possible measure.

Take a pinch as an opportunity of "reform"

From now on, we will coexist with COVID-19. It is called new normal. We have to consider what it will be like for these six months and one year
and after three to five years. Until when should we keep a social distance? When will people be allowed to move globally just as before? No one can foresee at present.

In the meantime, it is also true that we found the COVID-19 crisis could drive reforms. We were made aware how fragile the present business structure that depends on real stores is. As said before, our core business has existed by attracting customers from wide areas and thereby "creating close contact." If we cannot do this, we can take other approaches including e-commerce. Actually, however, the operation of our e-commerce is not completely independent of stores. We could not move products when our stores were closed. Furthermore, for tens of thousands of users of our gasho website, normally gasho staff serves them as a touch point and we did not think the website needs to have a payment function. All our systems are based on real stores. Amid the COVID-19 crisis, we see how much inconvenience it causes to customers, which results in opportunity loss.

In order to avoid employees' infection risk from traveling, we encouraged the employees of the entire Group mainly working in the head offices to work from home and actively held teleconferences and conference calls without getting together physically. In anticipation that such an era will come in the near future, we trialed them in some locations while building the infrastructure ensuring security. However, we did not even imagine we actually do them so soon. In practice, they are working well. At present, we cannot judge that they help increase productivity but problems in the operating process were revealed. Therefore, I think we will be able to produce robust results earlier than expected if we work on them seriously.

Creating the situation that "does not cause close contact" using digital to survive the COVID-19 era. In the past, it might be positioned rather as a complement to real stores, but from now on, we will have to improve ourselves centered on digital and using the strength of real stores. We cannot lose any time in responding to unprecedented dramatic changes. In this sense, I feel even more importance of the Group Vision "Create and Bring to Life 'New Happiness.'"

Review of the current medium-term plan and challenges

The Group aims to become a Multi Service Retailer beyond the framework of retail and works on expanding its business domain and transforming the business models of existing businesses. In order to expand our business domain, we opened a luxury mall “Ginza Six” and a commercial complex with office function “Ueno Frontier Tower” in 2017 and the Real Estate Business grew dramatically compared to before the current medium-term plan started. In the Credit and Finance Business, the management foundation was reinforced for medium-term growth by actively hiring specialized talents and they got prepared to issue “new cards,” which are a key to growth, this fiscal year.

In order to transform the business models of existing businesses, in September last year, we opened the "main building of the Daimaru Shinsaibashi store" as an unprecedented hybrid department store business model, and in November, we opened "new Shibuya Parco," which can reach a wide range of customers with an unconventional tenant mix. I see both produce results as expected. A challenge in the Department Store Business and the Parco Business is how we will horizontally apply these new business models to flagship stores speedily.

When we formulated the current medium-term plan, which started in 2017, we expected that profit would increase in fiscal year 2020 and beyond partly thanks to the full contribution of the development projects, which started business last year, after bottoming out in fiscal year 2019. However, it is unavoidable that the profit level will continue to decrease in fiscal year 2020 due to the current drastic environmental changes. In addition, the progress of new businesses from which a certain profit contribution is factored in is delayed. For these reasons, it became extremely difficult to achieve the profit target for fiscal year 2021, which is the final year of the medium-term plan.

While we see visible results that lead to a better future after three years have passed since the current medium-term plan started, in fact, we cannot say the progress of profit level and business portfolio transformation is smooth. I think behind that are the assumptions that have changed more greatly in "scale" and "speed" more than expected when we formulated
the current medium-term plan including lower consumer spending than expected after consumption tax hike, suddenly accelerated shrinkage of women's volume zone market and declining rural stores combined with less competitive urban flagship stores as well as the current COVID-19 pandemic risk.

On the other hand, the Group itself has faced an “important turning point.” It is conversion of Parco Co., Ltd, a consolidated subsidiary, into a “wholly owned subsidiary.” At last we could create a system that can aim to maximize synergy at higher speed by addressing dynamic transformation of business structure that we could not conduct before and drastically exchanging human resources through this conversion. I think this a big plus factor.

Amid these significant changes in external and internal environments, we have decided that it is the best to restart with a strategy that determines a direction with a far-sighted ambitious target and can bring out greater strength from the Group in a new system rather than continuing to implement the current medium-term plan in the present framework.

I think we have to formulate a new medium-term plan after clarifying what we could do, what and why we could not do.

**Started to formulate a new medium-term plan**

I would like to explain the outline of the Medium term Business Plan, which will start in fiscal year 2021 premised on creating a strong business structure considering the current uncertain situation, at the earnings announcement in October this year. As we have decided to give up the current medium-term plan halfway, after looking back on it properly, we would like to present accurate direction and “what we will be like in 2030,” ten years ahead, and clarify what we will aim to do for the first three years. To this end, we thoroughly analyzed the risks that will affect the Group. The five integral elements of the new medium-term plan will include “innovation,” “digital,” “global,” “sustainable” and “collaboration.” They are nothing special currently but a company may not be able to grow or even survive unless it can do them as a matter of course. For example, with respect to “global,” as asked at our annual shareholders meeting, you may wonder if we will be really all right considering the situation in which inbound sales, which are an element of global, disappeared amid global restrictions on travel due to the current COVID-19 crisis. However, we will not be able to stop the trend of going global and it may become obviously different from the past concept of global in the new normal. More active “collaboration” with outside will be needed to promote “digital” and “innovation.” I think we need to collaborate with outside more dynamically. Needless to say, “sustainable” means that a company cannot exist without producing both social value and economic value.

Currently we have many discussions concerning the new medium-term plan. Of the ten members who formulate the plan, only four including myself are from the department store. The remaining members are the ones from Parco and mid-career employees. As nine of the ten members who formulated the current medium-term plan were from the department store, I feel it has changed. Though there are still few women and people from outside, there is no doubt that the recent “conversion of Parco into a wholly owned subsidiary” will be a key factor in the formulation process and implementation of the new medium-term plan. I think we need to consider quantitatively what synergy we will be able to create. For this purpose, the department store and Parco should evolve further.

The Real Estate Business, which is growing steadily under the current medium-term plan, will be integrated into Parco, which accumulates more know-how. It is most expected among synergies from the recent conversion into a wholly owned subsidiary. Parco was mainly the developer of commercial complexes named Parco, but going forward, it will develop real estate in new fields as well as a commercial field.

The greatest of what we could not do under the current medium-term plan was the deep exploration of the growth strategy that aims to make us a Multi Service Retailer, that is, go beyond the framework of retail. As it is obvious that we cannot grow in a sustainable way if we stay within the framework of retail, our challenge is what we will define as the “fourth pillar” in addition to the existing pillars of the Group including department store, Parco and finance. To this end, I think we need synergy with Parco combined with external insights.

In the meantime, as management resources are limited, we will address structural reforms to overcome this crisis steadily. If we do something new, we have to clarify what to give up. The essence of choice and concentration is to decide what to abandon.

**Coexistence with a sustainable society**

In 2018, the Company identified five materiality 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” through the questionnaire survey for 4,250 stakeholders and discussions at the Management Meetings and the Board of Directors meetings. We set long-term goals for each of the five materiality issues and take specific actions in earnest to achieve them.

With regard to “contribution to a low-carbon society,” a retailer may not contribute greatly in terms of impact on the entire society. However, increased GHG emissions are one of the greatest global problems and we cannot just sit and wait. The Group’s CO₂ emissions are mainly from stores and approximately 90% of them are from electricity use.
Therefore, we will promote switch to renewable energy and LED lighting and electrify our corporate fleet. Thinking through what we can do now and taking the lead in putting it into specific action. I think that is all we need to do. As such actions, the GHG emissions reduction targets set by the Group was approved as science-based reduction targets by the international “Science Based Targets initiative (SBTi)” last year. The SBTi updated its target validation criteria so that the level of targets is classified under three categories. The Group’s targets were approved under the second strictest category of “well-below 2°C” aligned targets. We also support the final report released by the “Task Force on Climate-related Financial Disclosures (TCFD)” that was established by the Financial Stability Board (FSB) (TCFD recommendations), and at the same time, participated in the “TCFD Consortium” that was launched on May 27, 2019. Going forward, we will engage in dialogue with other companies and financial institutions which support these recommendations by participating in the TCFD Consortium to effectively disclose information on how we address the risks and opportunities of climate change, what initiatives we implement to achieve the long-term GHG emissions reduction targets, and so on.

With regard to “management of the entire supply chain,” we cannot do it without the understanding and cooperation of our suppliers. Therefore, we formulated our Principles of Action and the “Principles of Action for Suppliers” in June 2019 to eliminate environmental and social risks in the supply chain. Each operating company in the Group sent these “Principles of Action for Suppliers” to the representatives of suppliers to ensure that they understand and comply with the Group’s view and rules. In October, Daimaru Matsuakaya Department Stores, a main operating company, held a “presentation on the JFR Principles of Action for Suppliers” in Tokyo and Osaka at the same time and as many as 652 people from 530 companies attended it. I am convinced that both the Group and its suppliers deepened shared thought that they will aim to enhance corporate value by complying with the Principles of Action through them.

With regard to “coexistence with local communities,” needless to say, it is the very core business of the Group. We position five areas where our stores are located as key areas and implement the “Urban Dominant Strategy” that aims to grow with local communities with our stores at its core. In fiscal year 2020, the north wing of the Shinsaibashi store will open with Parco as an anchor tenant in fall and a new commercial complex will open in the Sakae area, Nagoya.

With regard to “promotion of diversity,” given further increasing human resource exchanges driver by the recent conversion of Parco into a wholly owned subsidiary, I think we have become a very diverse company. Recently, we actively hire people from outside. We hired 69 people only in fiscal year 2019, which is almost the same level as the new graduate recruitment. It is true that the Group mainly operating traditional department stores is rapidly becoming diverse. In addition, we adopt a unique “Mother Recruitment” program that aims to extensively hire women wishing to balance child care and work at a higher level from outside the Group. I think it is effective in securing motivated talents. In fact, however, there are still many men in management. So we would like to seriously consider a way to bring out employees’ personalities and abilities to the fullest and develop female human resources who will be included in a succession plan.

With regard to “realization of work-life balance,” it is important that a work style reform will be carried out not just to remedy long working hours but to make work creative and productive and balance work and life. Telework, which has become established, will steadily drive that. Creating a company whose employees enrich both their lives and works and take pride in the company. I think it will help people and a company achieve true growth.

**Further raise awareness of capital cost with ROIC**

I understand our cost of shareholders’ equity is in the range of 6 to 7% in the CAPM. I think an ROE of at least 8%, which exceeds the cost of shareholders’ equity, is the minimal level we should aim to achieve to enhance corporate value. We aim to build a business structure that can achieve an ROE of at least 8% on a consolidated basis continuously by breaking down ROE into its components to be addressed by operating units.

Operating units work to increase ROA, which is calculated by multiplying a company’s operating profit margin by its asset turnover. As the Department Store Business that operated using large assets of stores gave too much importance to P/L, I think this is the first step to change our mindset to see return from assets, that is, realize B/S-focused management. ROA was added as a store manager performance indicator. So I think the business management based on separate B/S for each store is steadily progressing. Furthermore, from fiscal year 2020, we will adopt an “internal capital system” that sets internal rules including an internal interest system, an internal tax system and an internal dividend system, like managing a company, as well as setting capital for each business and each store to further advance B/S-based management.

In terms of return on investment, we use the WACC as a hurdle rate. Our WACC is calculated at around 5% over the medium to long term. We also set the WACC for each business such as Department Store, Parco and Credit and Finance. As the WACC is the hurdle rate of ROIC, a positive spread between ROIC and WACC will help create corporate value. Though we do not formally adopt ROIC as a management indicator, it is true that ROIC is often referred to in dialogue.
with investors. Actually, when we released the current medium-term plan, an investor said that the spread of ROIC, which was calculated from total investment and forecast operating profit during the period of the medium-term plan, is not good enough. As a matter of course, it will be discussed in each business. That means investment should be made in the business that generates greater return. As ROE can be broken down into ROIC and leverage, it may be said to be a KPI that aims to fundamentally enhance ROE without relying on leverage. Based on these matters, we consider introducing ROIC as a KPI in the new medium-term plan, which is being formulated.

For investment projects, the “Investment Project Review Committee” with the Senior Executive General Manager of Financial Strategy Unit as its chairperson and the Senior General Manager of Management Planning Division as its vice-chairperson discusses them. We use the payback method for store renovations and the NPV method for development investment. For M&A, we use quantitative criteria including calculating shareholder value using the DCF method, creating risk scenarios and confirming impact on rating, etc. and also qualitative criteria to make a decision comprehensively. The results are reported to the Management Meetings and the Board of Directors and positioned as one factor in management decision.

The “Revitalization Plan Review Committee” also manages existing businesses in three phases. The Committee validates these businesses, examines the validity of their measures and provides information to the Management Meetings and the Board of Directors in a reasonable period of time.

**Deepen dialogue through highly transparent management**

We have addressed governance reforms continuously since the Corporate Governance Code was published in 2015. We were originally a Company with an Audit & Supervisory Board and made a transition to a Company with Three Committees (Nomination, Audit and Remuneration) in fiscal year 2017. At that time, five of 13 Directors were independent Outside Directors, and since 2019, we have added one and have six in total to further strengthen oversight function by adding external perspectives.

I think it is the most important for governance to increase the transparency of management. Transparency is enhanced by actively disclosing information, and without doing so, we cannot promote constructive dialogue. For example, as it is difficult to foresee the future in the current COVID-19 crisis, many companies with fiscal year-ends in February and March announced that earnings forecasts "were to be determined.” However, we disclosed earnings forecasts as always. It was not easy to forecast in the situation changing every moment: but the management of a company remains based on a certain assumption made considering the environment around it. Therefore, we made forecasts by analyzing information available until the end of March and disclosed them at our earnings announcement in early April. It is because I think opening gambits for discussion with capital markets are provided and dialogue is deepened by showing the standards set by our management. A state of emergency was declared immediately after that and this assumption changed. However, I feel the dialogue conducted there was meaningful and highly suggestive, which will lead to the next step.

This is really the "emergency situation." The succession plan was implemented in such situation and I got a baton as the President, in which I feel sort of destiny. As the environment changed so drastically, we need to reset our mind. Clinging to past successes thinking easily that everything will get back on the track is just a risk. My job may start from “letting go of past successes.” The new era drives the acceleration of changes and I see it as an opportunity to seek the new way to operate the businesses of the Group. Since it is difficult to foresee the future, it is important to beef up efforts to disclose information, encourage beneficial dialogue and reflect many insights thus obtained in management activities. We would like to draw out solutions in the COVID-19 era, overcome this crisis steadily with stakeholders and strive to grow in a sustainable way and enhance corporate value over the medium to long term.