A Company that Profits and Grows Structurally

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The desire to see a company's corporate value improve is shared by entrepreneurs and investors.

Although both parties are partners in creating value, the roles they play in this process are fundamentally different.

However, it is out of the interplay between this shared perspective and these differences that entrepreneurs and investors are able to engage in a frank dialectic to further their mutual growth and contribute to the long-term interests of society.

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Dialectic with Companies from the Perspective of a Long-Term Investor

Aoi: Mr. Okuno, your idea regarding long-term capital allocation—that entrepreneurs and long-term investors should be on the same side, but not on the same team—is very intriguing. An effective dialectic can be generated due to both parties being on different teams on the same side, that is to say, working for the same goal, and this dialectic can enhance corporate value. In other words, the returns of long-term investment contribute to the interests of both parties.
Okuno: There are, of course, long-term investors that seek to improve the corporate value of investment targets by joining the same team as these companies. It is not so much that either approach is better, but is rather that both approaches entail judging entrepreneurs by different perspectives.
Aoi: Long-term investors that join the same team and those that stay on different teams may have differing investment styles, but I believe that they both share the perspective of creating something together with the companies in which they invest. MARUI GROUP's corporate philosophy is founded on the concept of creating together, or co-creation. Accordingly, I see corporate value as being best created through close-knit relationships with investors, or by encouraging co-creation with both parties on the same team. Your investment style, Mr. Okuno, represents a 180-degree turn from this idea.
Okuno: I have been conducting long-term investment in companies, both domestic and overseas, for a decade. Over this time, I have learned that quality companies share something fundamental. Some may call this something the essence of their business or their nature, but I refer to it as their "structure." As investors, we survey various industries and select the most "structurally robust companies" from these industries to invest in. The leaders of companies will change over time. It is as Warren Buffett is always saying; rather than focusing on leaders, it is better to invest in companies that would still be successful even if they did not have a leader.

Entrepreneurs and long-term investors both decide to which businesses they will allocate their capital by judging the economic feasibility of each business, looking at the value they provide, their competitiveness, and the long-term trends then can expect to see. As seen in the acquisition of Sankyo Seiki Mfg. Co., Ltd., by NIDEC CORPORATION, it is possible to alter the structure of entire industries by allocating resources to peripheral businesses, all the while maintaining the strengths that keep a business running. Investors do not actively influence the structures of industries. However, if we can see the logic behind a company's earning mechanisms, we will allocate resources to that company. As a result, we come to invest in various companies regardless of their industry or country. The desire to see a company's corporate value improve is shared by entrepreneurs and investors. With this passion as a foundation, it is the interplay between this shared perspective and the differences of both parties that enable them to engage in a frank dialectic.

Business Built on a Combination of Finance and Retailing Expertise

Aoi: When I was in North America as part of our investor relations activities, an institutional investor described MARUI GROUP as having a "bad industry, but good management." Although this individual was in favor of the new business model we are creating, he stated that we may be in a bad industry in reference to our involvement in the retailing, department store, and credit card industries as well as to our relatively low stock price. This investor was unable to understand our unique position even when I explained that MARUI GROUP's credit card transactions have been growing by 17% on average over the past 10 years and how our ratio of delinquent debt is the lowest in the industry at 1.45%.
Okuno: I personally feel that neither the retail industry nor the financial industry is inherently a "bad industry." In these industries, corporate managers are united in their sentiment that connections with customers are of utmost importance to providing value.

Kazushige Okuno
Managing Director (CIO)
Norinchukin Value Investments Co., Ltd.

After graduating from the Faculty of Law at Kyoto University, Mr. Kazushige Okuno joined The Long-Term Credit Bank of Japan in 1992. He later took positions at LTCB Securities and then UBS Securities. In 2003, he joined The Norinchukin Bank and also received a Master's in Finance from the London Business School. Mr. Okuno started a project to manage a proprietary internal fund of long-term concentrated portfolios in 2007. This project was transferred to The Norinchukin Trust and Banking Co., Ltd., in 2009, where Mr. Okuno provided fund advisory services for other institutional investors, including pension funds. In 2014, he was reassigned to Norinchukin Value Investments Co., Ltd., a specialized company concentrating on the investment advisory business, where he remains today.

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—— **Kazushige Okuno**

I have previously viewed MARUI GROUP as a retailer, but I now think that the Company may actually be a financial company with retail operations. MARUI GROUP's store network enables it to gather information on customer needs. Here, I see the business model of a financial company that understands retailing, or perhaps a retailer that understands finance. This model is complemented by MARUI GROUP's profession change system, which allows employees from retailing or finance backgrounds to be relocated to other Group companies. MARUI GROUP is unprecedented in having finance field connections with customers, despite being a retailer. I have high praise for the Company's business, which merges retailing and finance. However, I also see a need to translate this business into concrete numbers or present it as a clear business model.
Aoi: We have continued to develop this business based on tacitly held knowledge, and it is therefore not uncommon for people to request that we put forth a clear picture of our business model. Our business model underwent a drastic change when we sought to pull our retail stores out of a bad industry through business structure transformation. However, at a glance, our stores may not appear to be very different from the department store model we had employed previously. While one could say that it is enough so long as our credit card operations grow and profit, if all of our business knowledge is tacit, we will not be able to furnish an effective response should the operating environment change. It is therefore crucial that we transform this tacit knowledge into explicit knowledge so that we can continue accurately transmitting it to new generations of employees. This process will be vital to maintaining our strengths. If our knowledge can be transmitted in this way, the Company will become structurally profitable, which is, in essence, the same as being structurally capable of growing with a manager.
Okuno: That is part of what makes business models interesting. Business models are templates. Whether or not investors will be in favor of a business model is determined by whether or not that business model can be logically linked to numbers. This is an important fact to reflect upon.

Breakthrough Achieved by Merging Retailing and Finance

Okuno: It is also important for business models to be predicated on some sort of major breakthrough. Looking at MARUI GROUP as a financial company with sales floors, I see numerous possibilities, such as providing

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——— **Hiroshi Aoi**

surplus capacity as a service. Businesses that are built on fixed assets, such as commercial facilities, are inherently sharing economies.

Aoi: We are transitioning to a real estate model for operating our stores. Under this model, our directly managed sales floors function more as showrooms, with our main focus being on e-commerce operations. Treating our stores as real estate means that we do not need to sell products like a department store; all we need to do is rent space. For example, we could introduce tenants such as shared offices, co-working spaces, or classrooms. We aim to transform the sharing economy born out of such tenants into a new business.

Okuno: Changes to your business model will unlock a wider range of opportunities, but will also expose you to the risk of more competitors encroaching on your market. For this reason, it is important for the Company to have thoroughly entrenched strengths. I suspect that MARUI GROUP's main strength lies in its cardholder base. Moreover, the cards you provide are equipped with IC chips, which can be seen as a technology with the potential to create various new business opportunities.

Aoi: If we only provide functions that can be easily imitated, we will soon be overwhelmed by the competition, making it impossible to grow or to secure sufficient profit margins. We are thus looking to create a unique, membership-based business by combining our retailing operations with our credit cards. This model will open up the possibility of offering membership and other subscription services, which we will in turn contribute to the growth of credit cards if we can encourage users to pay their monthly subscription fees with our credit cards. If customers continue using our cards, the inherent value of these cards will grow, and our profit margins will increase rapidly. In this manner, I see success in business as hinging on the degree to which a company is able to combine a number of unique offerings.

Multi-Party, Two-Way Communication via the Internet

Okuno: When viewing a business model from an abstract perspective, there are no doubt elements that will change and others that will not. In identifying these elements, it is important not to be constrained by past history or successes, but instead to continually observe the situation from a fresh perspective. One area in which change will occur pertains to the Internet. We have never before seen an era that has been so interconnected by the Internet. This new era is giving rise to a global trend toward individualism, with specific needs originating directly from individual people. Accordingly, it is no longer sufficient for companies to mass-produce a small lineup of products, which has previously been the norm.

Aoi: That view really resonates with me. In order to share our long-term operating environment analyses with Group employees, we chose to hold a meeting at which we discussed the main differences from the 20th century that we expect to see in the 21st century. The conclusion we reached was that the biggest difference would be the presence of the Internet and the resulting changes in forms of communication. In the past, communication has generally been in the form of one-on-one communication or of transmission for one individual to a "large group of others." However, the advent of the Internet enabled two-way communication to take place between multiple parties. This new form of communication will likely result in the emergence of consumer-to-consumer business models that differ from traditional business-to-consumer models. One example of such a model can be seen in peer-to-peer Internet sales applications.

Okuno: I believe that one of MARUI GROUP's strengths lies in its connections with customers. These connections could make it possible to, for example, issue straight bonds, which are normally aimed at professional investors, to standard consumers. If this were to be done, it would mean that both the asset and liability portions of the balance sheet would be directly connected to customers. Given that it is when companies cannot pay back their debt that they go bankrupt, diversifying funding sources is crucial to a company's survival. The era of multi-party, two-way communication via the Internet makes such diversification possible.

Alternative and Inclusion Perspectives for Viewing Demographic Trends

Okuno: Another change will be a decline in growth potential as a result of demographic trends. The fact that Japan's population of approximately 126.8 million people will decline going forward seems self-evident, but is this actually true? Judging by this projected decline in population, it would seem that Japan's retail industry is doomed to fail. However, if we look at urban areas, for example, we can find areas in which the population is actually growing. Institutional investors view demographic trends from this alternative perspective when conducting investments, and this perspective leads us to understand trends differently. MARUI GROUP's business model is interesting in how its stores are concentrated in urban areas.

Aoi: At MARUI GROUP, we view demographic trends, such as the aging and shrinking population and the decline in the birthrate, from a perspective of inclusion. As such, we aim to be a forerunner in the development of operations that are inclusive of differently abled individuals, non-Japanese people, and members of the LGBT community of people of all ages and genders. In the past, our credit card services operations have sought to serve youths and young adults as well as people in the low- and middle-income brackets, demographics that were unable to take advantage of existing financial services. This experience has given us a sort of template to work from in promoting inclusion. Taking your alternative perspective to demographic trends, it will be enough if the number of our customers increases, even if the overall population declines. Accordingly, our task going forward will be to find ways to link the knowledge, expertise, and other wellsprings of differentiation we have cultivated to date to the growth of our customer base.

Okuno: In terms of creating value, entrepreneurs seek to create 1 from 0, while long-term investors, such as myself, strive to efficiently grow the 1 created by entrepreneurs to 100. Conversely, if we provide equity to a company that will go from 0 to -1, this will quickly be transformed to a -100. In the most extreme cases, such as the financial crisis of 2008, this -100 can bear the risk of setting off a global recession. In light of this risk, I always endeavor to identify whether an entrepreneur will create 1 or -1 through my interactions with them. This is one way that long-term investors contribute to a better world. I hope that MARUI GROUP will remain a company that creates 1's.

Aoi: To look at the same idea from a different perspective, if a company chooses the wrong investor to become engaged with, it will run the risk of being led in a bad direction. I enjoyed having this frank conversation with you today. It was a clash of ideas between professionals of the best possible kind and very refreshing. Looking ahead, I hope to pursue the type of mutual growth with investors that you speak of in order to contribute to the long-term interests of society.