JAPANESE CONVENIENCE STORES’

Telematic Approach to Gaining an E-Commerce Advantage

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February 2003
INTRODUCTION

Retailing entered a new era when Jeffrey Bezos opened the “Amazon” website in 1995. It was the first serious effort to sell products directly to consumers using the Internet. This e-commerce business model is often called Business to Consumer or “B2C”. It began as an electronic emulation of catalogue selling. A website substitutes for the paper catalogue. Because of a well-developed US retail catalogue segment, consumers understood substituting the Internet for catalogues. The perceived advantages of B2C included 24-hour shopping convenience without a phone call and time to freely browse information related to promotional sale prices or out-of-stock items.

A number of online start-ups followed Amazon, offering many products and services. Companies like e-Toys, Pet.com, JourneyEd.com, Priceline.com and E-Bay.com emerged. Some had viable business models, but many organized mostly to respond to the inflated demand for Internet IPOs that encouraged Internet entrepreneurs to raise hundreds of millions of dollars. Yet, most B2C online sellers (e-tailers) could not break-even. To compete effectively with traditional retailers and get buyers to change traditional purchasing habits, many used their cash hoards to attract customers by offering products at steep discounts. They often had to compensate consumers for the shipping costs. These factors along with the substantial initial investment for computer hardware and developing systems generally created a negative cash flow their businesses could not justify. So they quickly used the billions raised from venture capitalists and IPO investors. Unfortunately, many failed. Yet, the B2C e-tailing approach remains an important e-commerce model we will term the Amazon or “A” model.

The phenomenal growth of the B2C e-tailing start-ups combined with Wall Street and media hype shook the retail industry. Under pressure to enter the “new economy” traditional retailers took desperate moves to aggressively enter e-tailing. Several created websites and established related tracking stocks so they could also raise capital cheaply or make acquisitions for stock on a basis similar to the e-tailing start-ups. Barnes & Noble, a hundred year old bookseller with stores across the US, opened its barnesandnoble.com website in 1997 and later established a separate tracking stock. (It subsequently collapsed this back into the parent in 2001 given large losses in its e-tailing activities and collapse of the dot.com mania.) Other retailers such as Toys “R” Us, L. L. Bean and Wal-Mart followed similar e-tailing entry strategies. This B2C e-tailing model is popularly known as “bricks-and-clicks” due to these firms’ physical retailing infrastructures. We term this B2C e-tailing business as the “B&N” model.
Over time, this model seemed to have some advantages over the “A” type. First, they had existing capital and cash flow to invest in the e-tailing ventures. They thus had less need for VCs, had better control over their operations, and were less dependent on online sales and their website to generate cash. Moreover, many could leverage their brands, permitting them to spend less on advertising. A related advantage was greater consumer confidence since the stores’ presence meant consumers had the option of picking-up or returning merchandise at there. This meant customers could order online but take delivery at a store, saving shipping charges. Similarly, they were not dependent on trips to the post office or calls to UPS for returns. In addition, complaints could be handled in person, not always remotely online. B&N e-tailers also accepted payment for online purchases in their stores, reassuring customers reluctant to give away credit card information online. These options made delivery, payment and returns faster, less expensive, and more convenient for customers living close to the e-tailer’s retail stores. Yet, they did not sacrifice the convenience of 24-hour access or the ability to conveniently browse in their homes. To emulate these B&N advantages, the A types started building their own physical infrastructures such as automated warehouses and selling booths in shopping malls. Some also used inflated stock values prior to the dot.com collapse to acquire existing retailers in their markets.

In this way there has been convergence between e-tailing start-ups that have survived and traditional retailers that entered the online retailing business, with each trying to achieve an optimal competitive combination of web and “bricks-and-mortar” sales. In this way the B&N model seems to have emerged during the 1998-2001 period as the e-tailing approach most likely to succeed in the “new economy”. This is especially true when one recognizes another competitive advantage for traditional firms - management’s existing knowledge of customers and an industry’s economics. Amazingly, many A-type B2C retailers had no such previous experience.

**EMERGING E-TAILING DIFFICULTIES**

This is why the hype and promise of the “new economy” did not last long and a more rational e-commerce business model has emerged. In this model e-tailing has become another channel to reach customers but not the only one. Further it must be combined with support facilities. The collapse of the NASDAQ has reflected this reality as it housed most e-commerce stocks and their hi-tech suppliers. With the demise of the dot.com competition and e-commerce hype, the B&N e-tailers pulled back sharply on new investments as even most B&N firms lost money.
This paper will focus on three related issues that seem especially important. First, these e-tailing businesses did not add much value within the retailing value chain. Most e-tailers depend on third party shippers such as FedEx or UPS for delivery. They are expensive and e-tailers could not economically compensate customers for shipping costs given their margins and the cost of building, operating and advertising their sites. Second, while sales growth was impressive, consumers did not flock to online purchasing to the extent expected. Though it is often easier to order online and get delivery at home than go to a store, many did continue to go to stores for the final sale to see and feel prior to purchase. Finally, e-tailers had no proprietary interest in the products sold and given the second consideration could not achieve volume sales to give them an advantage over large B&N sellers. These factors when combined with potentially insecure payment mechanisms, limited Internet access, and higher than expected advertising costs made many B2C e-commerce business models unprofitable even for the B&N retailers. The question then is whether there is another approach that could overcome some of these drawbacks and help realize the potential of e-tailing, especially in countries that do not have the US’s extensive PC/Internet infrastructure.

**AN ALTERNATIVE E-TAILING BUSINESS MODEL – THE JAPANESE CONVENIENCE STORE (CVS) AND TELEMATICS**

This B2C model is developing rapidly in Japan. Though it is based on many traditional aspects of Japanese business and consumer retailing, two considerations appear key. One is most consumers pay cash for purchases and two, firms are used to forming cooperative alliances to take advantage of new business opportunities with each delivering its own expertise. The latter occurs because Japan’s long-term employment system makes it difficult to quickly recruit new expertise the way US e-tailing could rapidly attract new personnel at all levels by offering stock incentives and other perks. The new IT-based alliances, however, are different than traditional horizontal or vertical company groupings common in certain industries. In those cases, there has generally been extensive inter-firm ownership as well as exchange of personnel. In the new IT based alliances, which we term e-retsu, there is often

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1 Telematics in the 80s referred to interactive computer mediated communications. Currently it covers the intersection of informatics (processing data for application goals) and telecommunications, especially wireless in a mobile environment. This applied telecommunications in a data rich environment can incorporate businesses where pervasive computing intersects with e- and m-commerce as well as intelligent transportation systems that link mobile and wired solutions to achieve a multi-media result. Toyota estimates such activities and related goods and services will grow to a 60 trillion yen market in Japan by 2015 (Toyota 1999). This explains why Toyota, Japanese CVS and Japanese consumer electronics companies along with mobile phone companies and leading systems houses are heavily involved. The following assessments of two leading CVS in e- and m-commerce illustrate the powerful economic and competitive advantages flowing from systematic use and application of integrated telematic solutions.
no previous such relationship and no cross shareholdings. Common shareholding is in the e-retsu company. Firms’ motivation in forming such alliances is to pool expertise in a new venture where all parties hold shares.

The common goal is to share expertise and personnel to exploit what they jointly see as an e- and/or m-commerce opportunity. In addition to quickly raising capital and pooling business and technical expertise, this structure substitutes for the scarcity of venture capital in Japan while leveraging the investors’ R&D and brand recognition. Further, because each partner provides its products and expertise, these B2C e-tailing activities cover a larger part of the value added chain than A or B&N models. From an e-tailing perspective the most interesting e-retsus are those based on convenience stores (CVS), which can also capture a larger part of the payment and delivery components of the value chain. The balance of the paper will focus on these CVS and the strategies of the two leading firms in using partners and telematic solutions to achieve their goals and create competitive barriers.

**CVS IN JAPAN**

To understand this e-tailing model it is important to grasp certain fundamentals about Japanese CVS and how they differ from such US stores. These differences are found especially in the strategies of leading firms driving its development, particularly Ito-Yokado and its subsidiary, Seven-Eleven Japan (SEJ). Despite Japan’s extended economic malaise, large CVS have enjoyed relatively better performance than other retailers in the 1990s. Sales rose from ¥3.89 trillion in fiscal 1993 to ¥6.18 trillion in fiscal 1998, with sales falling only slightly in fiscal 1999 to ¥6.13 trillion, then remaining level in fiscal 2001 at ¥6.14 trillion despite general deflation. However, competition among CVS and against other retailers has increased, and the time is gone when the whole sector enjoyed growth.

Now, only large better managed CVS can grow faster given better merchandising strategies, including more services; greater use of IT; superior site selection; and finally better owner (franchisee) development. Given these advantages deregulation increasing the merchandise and services CVS can offer favors the leading chains. This is because the bigger ones, and especially 7/11, can offer more seasonal and promotional items, geographical variations in stock, and extensive and constantly changing fast-food and service offerings. Further, new services such as financial services require sophisticated training of storeowners and their employees plus good field support. Only, leading chains have this capability. Indeed, it is generally agreed that SEJ has achieved its leading position
through flexibly supplying its stores with a wide variety of goods and services, especially with different food items during the day. Having sales per store and per square meter at least 50 percent higher than its major competitors became an even more important advantage as the CVS market saturated during the 1990s with a surge in the number of stores. During this period the population per store fell below the 3,000 usually regarded as the critical viability level. In major urban areas the situation became even more unfavorable: in Tokyo around 2,000 and in Osaka, even less. However, during this period the major chains could distinguish between their high-quality stores and the lower-quality ones called CVS just because they are open 24 hours. In 1996 for example, the total number of CVS (48,567) included every type satisfying the definition. But of those, only about 32,000 provided the other usual CVS services such as postage stamps, copiers, fax machines, video games, utility bill payment, and package delivery. Thus the population per high-quality store may have been about 4,000. So quality operations during the late 1990s could add as many as 10,000 stores. But marginal stores could not survive this increased competition, and the number of CVS declined by 9,000 to 39,627 by early 2001. Since this shakeout the feeling is saturation has been reached even for higher-quality stores while the number of marginal stores is much lower. The recently announced strategies for even leading firms has therefore been to not expand the number of stores but to replace existing ones operating less successfully with new stores in different locations that have better market potential and can sell alcohol. For example, SEJ’s percentage of stores selling alcohol rose from about 35% in 1991 to about 63% in 2001.

These competitive trends are indicated by the fact in 1996 the number of scrapped stores per listed CVS was only about 100 per year, or about 20% of openings, compared to the current rough equality. During the 1990s the share of stores of the 8 major CVS rose from 21% in 1985, to 30% in 1990, to 40% in 1995 and 43% in 1996. By 2000 the top six (now top 5) had 65% of the stores and over 80% of total CVS sales. But by the end of the 1990s even larger chains came under pressure. This is why even leading stores now limit their rapid expansion, with Lawson and FamilyMart in early 2001 announcing closures and relocations of hundreds of lower-performing stores with planned openings in more-promising locations and/or those having liquor licenses. For example FamilyMart’s stores with such licenses increased from 1901 in FY 2000 to 2279 in 2001.

Similarly, Lawson’s EVP noted (Lawson’s 2001 Annual Report) in fiscal 2001 they “expect to open 650 stores, a roughly 10% decline compared to openings in fiscal 2000. Thereafter, we will adhere to our policy of not overextending ourselves by opening new stores where the numbers don’t justify it.” But despite increased competition, SEJ is using its greater efficiency to increase market share. Since
1993 it has opened 400-500 stores per year and during 2001 had a backlog of about 500 waiting to be opened, while stating its intention to steadily increase its stores and location dominance. SEJ’s strategic success is reflected in average daily sales for new stores since 1995 of over 520,000 yen, greater than the average for existing stores among competitors. Further, most have licenses to sell liquor since the number increased from 5115 in FY 2000 to 5427 in FY 2001. This may be why average daily visits per store are up about 20% since 1982 while average sale per customer has risen from 600 yen to over 800 yen and the average gross margin has gone from a little over 26% to over 30%. (FM in 2001 was 600 yen.)

**CVS merchandising strategy**

This approach is combined with expanded services, the second part of a two-prong strategy lying behind their e-retsu e-tailing initiatives. A leading CVS strategy has been to continually add services to attract traffic, even if they do not contribute directly to profits. Many have long offered copying, fax services, and video games. In 1987 they became payment points for electricity, gas, and water bills. (SEJ was the first and reports having 3% of total Japanese payments in 2000, including those through banks and postal offices.) In February 1989 SEJ accepted payments for Daiichi Seimei (life insurance). As deregulation has allowed, CVS have added money orders, postage stamps, and rice (1996). Foreign exchange started in 1998 and package shipping in the mid-90s where SEJ works with Yamato Unyu, Japan's largest package-delivery firm. During FY 2001, SEJ handled over 13.5 million packages. In 1999 SEJ began accepting payment for purchases made over the Internet as part of its e-retsu strategy. Reservation for travel became available in late 2000. With these new offerings, existing CVS sales began rising again. These activities’ success shows Japan is still cash using, and even those with credit cards prefer not to give numbers over the phone or Internet. In FY 2001 SEJ handled over ¥800 billion in such payments on behalf of 245 companies involving over 100 million transactions. Further, over 75% of Internet purchases are currently paid in CVS. More recently as deregulation continues banking and financial services are offered. Working couples needing such services outside normal banking hours have been targeted. Several have initiated plans to act as automated bank branches with ATMs. While IY has established its own bank, Lawson, FamilyMart and other CVS have entered into alliances with banks that install and service the ATMs. Other IT alliances focus on entertainment, games, and other services as detailed in the following case studies. Yet handling this wide range of services requires thought, support, and staff training. The implication is although a CVS can add items and services, not all chains can do it well and profitably. Further, several new products and services, especially financial ones, are IT intensive. The store ideally wants customers to buy
lunch, a magazine for later, and a toiletry, while checking bank balances, making payments, or trading stocks. This favors leading firms with the most sophisticated and wealthy partners.

Selection of franchisees and good sites thus remain important to a successful CVS strategy because competition for new stores in promising areas has reduced the average quality of both. Some chains’ staff responsible for developing new stores and advising new owners is not competent. But competence is important when more complex services are added. SEJ's store-support staff of 1500 is thus key to its competitive strength. Since franchise-closing costs are far higher than opening costs, CVS firms must pay attention to relations, support, and contracts with franchisees. In turn sophisticated partners that want to improve their chances for e-commerce success will tend to align with the more successful CVS. This contributes to potential success of the e-tailing venture and the CVS, a beneficial loop.

**Key strategic differences in CVS E-tailing Business Model**

One difficulty in applying an “A” e-tailing business model has been the small part of the value chain it occupies between producing a good or service and the customer. Amazon does not produce the books, CDs and other items it sells while 3d parties provide delivery (UPS or Fed-Ex) and payment (credit card). So to amortize its high fixed hardware and systems costs Amazon must generate economies of scope by expanding what it offers. (E-bay shows how economies of scope can be employed to achieve a successful e-tailing venture using the “A” model.) The failure of ventures with limited markets such as E-toy that could not generate economies of scope shows the strategic risks in using the A model to penetrate an e-tailing segment. This is especially true if a B&N type competitor can occupy it and the interaction between returns and customer satisfaction is important. The B&N model has proved superior because it captures a larger part of the value added stream including parts of the delivery and payment costs as well as lower cost for returns with better customer satisfaction However, the B&N model is less well positioned to develop economies of scope since the “bricks” part of the business is generally specialized.

But as case studies for SEJ, Lawson and FamilyMart show the Japanese CVS model addresses the potential e-tailing limitations of the “A” and “B&N” models. Through their websites and catalogues, they can generate economies of scope. By using their convenience stores as payment and pick-up centers they can achieve the greater value added and better handling of returns of the B&N model. Further, through their e-retsu partnerships they can create and/or capture some product value while extending their activities into telematic relationships with a wide variety of customers and suppliers.
By including content providers as shareholders in the e-tailing ventures, they gain a part of the value added stream that neither A or B&N models do. Finally, via their multimedia kiosks (MMKs), they are increasing store traffic using telematic means that improves revenues in their basic retailing, an externality to the e-tailing venture. To the extent they already use sophisticated data gathering systems to track and deliver customers’ purchases by store, item, time of day, weather, and special events, e- and m-commerce become extensions of their supplier relationships and telematic approach (Rapp 2002). For these reasons, the cases bear study as an approach to e-tailing’s emergence as a growth market and as an indicator of Telematics’ effect on e- and m-commerce.

SEVEN ELEVEN JAPAN (SEJ)

SEJ and Sony, for example, have an agreement to offer high-speed downloading of games for PlayStation 2 using a centralized server containing all current games. This means an SEJ store can offer a total selection, but only has to inventory blank CDs. Players now have a convenient alternative to downloading over a slow expensive phone line. Upgrades are easy for a small fee. Such e-commerce has taken strong hold in Japan but has been evolving differently than the US. With Nomura Research Institute’s (NRI) help, IY and SEJ are moving quickly and decisively to have an impact on this e-commerce development, using a customer-driven strategy where convenience goes well beyond what is normally associated with CVS. To make this approach work requires developing a convenient and secure payment mechanism with which customers feel comfortable. Because many Japanese do not trust giving credit card numbers over the Internet or phone, while others just prefer to pay cash, combining e-commerce websites with a CVS chain allows people to pay and take product delivery at conveniently located stores. This process facilitates returns similar to the B&N model but is an evolutionary extension of SEJ’s third-party payment service. This did over 126 million transactions in FY 2002 up from 105 million in FY 2001 and 86 million in 2000 with a value of 813 billion yen in 2001 compared to 641 billion in FY2000. It also complements its parcel delivery service that handled 13.8 million parcels in FY 2002.² In Japan it is now common to order items such as books, video

²In IY’s 20-F filing for FY 2002, it explains its approach to using IT to gain an advantage. See also Rapp (2002). "An item-by-item inventory control method has been at the core of the Company’s merchandising strategy. This method involves distinguishing fast-moving items from slow-moving ones, examining these differences, taking due care of the main features (for example, color, design, size, taste, durability, sales methods and price) between them and making hypotheses for the business plans. The item-by-item inventory control is made more precise by the processing of a computerized point of sales system, POS. … Based on the data, fast-moving items are stocked sufficiently and slow-moving items are reduced immediately. Further, this method ensures that the products customers want to purchase are always in stock thereby reducing lost sale opportunities due to items being out-of-stock. This concept is fundamental in merchandising. Through the continuation of the item-by-item inventory control, Ito-Yokado believes that its operation has succeeded in maintaining a higher level of
games, and CDs through the Internet using the CVS for payment and delivery. SEJ has led this change. In 1999 it established joint ventures such as e-Shopping!Books with Softbank, Tohan, and Yahoo!Japan, and CarPoint Japan for car sales with Softbank, Microsoft, and Yahoo!Japan. The 3 million customers of Japan's largest virtual mall, Rakuten Ichiba (rakuten.co.jp), use SEJ stores to make their payments and pick-up packages if they do not want them delivered. IY reports about 75% of shoppers on its websites pick-up and pay at stores. Further, SEJ and NRI have started clearing services for purchasing through the Internet. There is also Seven-Meal Service “for customers who find daily meal preparation inconvenient”; they “place orders through telephone, fax, the Internet and at stores and choose whether to receive the products at home or at a nearby Seven-Eleven store.” (SEJ Outline)

7dream.com
In January 2000, SEJ and NRI announced a new B2C e-retsu (firm based on IT relations) with ¥5 billion capital. Called 7dream.com, SEJ intends it to be “one of the largest EC [e-commerce] businesses in Japan and operate at the forefront of its field”. It provides many services on its website and all eventually will be accessible from SEJ’s MMKs. Keeping with NRI's recommendations that an e-commerce access strategy should be “ubiquitous”, one can access 7dream via the Internet, including mobile phones and direct TV, or using catalogues available in SEJ stores. As seen in Table 1, through its e-retsu members the firm offers many services. These include travel, music, gifts, mobile phones, event tickets (using PIA), books (e-Shopping!Books), car services (sales

efficiency, a lower level of inventory while at the same time meeting customers’ needs consistently. In addition, various merchandising strategies of Ito-Yokado have been based on this item-by-item inventory control. … While this method requires Ito-Yokado to forecast adequate levels of inventory precisely, Ito-Yokado's item-by-item inventory control allows Ito-Yokado to maintain inventory based on data reflecting current consumer trends. By relieving Ito-Yokado's suppliers from having to take back unsold merchandise, Ito-Yokado keeps costs down and retains a right to decide appropriate production volume to meet product sales trends.”

2 According to IY’s Form 20-F filing, “Kabushiki Kaisha “7dream.com”, which Seven-Eleven Japan established jointly with seven other companies in February 2000, launched an Internet shopping site. Through this site, Seven-Eleven Japan is developing an e-commerce business based on convenience store, distribution and information networks. 7dream.com has offered various services for customers including order, pick-up, and pay for such transactions as shopping, buying books, downloading music, printing digital photos, applying for cellular phones, and requesting same day hotel reservations. The installation of multimedia terminals, which enable customers to order the above-services from 7-Eleven stores, began in November 2000. Net sales in fiscal years 2001 and 2002 were 617 million yen and 1,170 million yen ($8,731 thousand), respectively.” The Seven-Meal Service was “Jointly established in August 2000 with three other companies, Seven-Meal Service Co., Ltd. (“Seven-Meal Service”), uses Seven-Eleven Japan’s production, distribution, and information networks to operate a meal delivery service. At the end of February 2002, the services were available in areas covering approximately 3,000 7-Eleven stores. Customers can select from a menu of various items, including fully prepared meals and packages of cooking ingredients. Items can be ordered by telephone, facsimile, and Internet or at 7-Eleven stores. Delivery is made using special vehicles that can keep the food at required temperatures or the food may be picked up at 7-Eleven stores. Net sales in fiscal years 2001 and 2002 were 17 million yen and 478 million yen ($3,567 thousand), respectively.”
via CarPoint and, later, arranging auto inspections, repairs, driving lessons, and rental cars), and information services for entertainment, digital photographs, and special examinations in partnership with firms such as Toppan Printing and JMA Management Center. Table 1 lists the ownership plus expertise and services each brings to the venture. As of August 2001 there were about 1,200 7dream terminals in 7-Eleven stores in Tokyo, with a rollout elsewhere planned for the next few years. This has been tracking with 3500 kiosks installed as of February 2003. Meanwhile, anyone can order from the web site, the call center, or in a store using the monthly catalog. Catalog offerings are non-bulky because stores have limited space for holding items until picked up. Similar to other chains catalogs contain items not offered via the kiosks, which currently focus on tickets, CDs, and games. SEJ expected start-up costs to be around ¥40 billion and projected annual sales of about ¥150 billion for 2002 and ¥300 billion for 2004. Results so far have been short of expectations as 7Dream, IY Bank, IY Card, and Seven Meal Service together generated revenues for IY on an equity basis of 14.5 billion yen during Fiscal 2002 and losses of 13 billion. Still the project offers IY tremendous opportunities to enlarge the goods and services available at SEJ stores, including banking and financial services.

Table 1

<table>
<thead>
<tr>
<th>7dream.com Owners/e-retsu Members</th>
<th>Ownership (percentage)</th>
<th>Expertise and services provided</th>
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<tbody>
<tr>
<td>SEJ (51%)</td>
<td>Principal organizer; provides places for kiosks to access website.</td>
<td></td>
</tr>
<tr>
<td>NRI (13%)</td>
<td>Advises structuring business, as well as developing and operating e-commerce system.</td>
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</tr>
<tr>
<td>NEC (13%)</td>
<td>Built/operates 7.dream website. Designed/developed multimedia terminals, all connected via dedicated lines.</td>
<td></td>
</tr>
<tr>
<td>Sony (6.5%)</td>
<td>Supplies technological support related to its MD (mini-disk) and IC card technologies.</td>
<td></td>
</tr>
<tr>
<td>Sony Marketing (6.5%)</td>
<td>see Sony, includes online packaged music and games</td>
<td></td>
</tr>
<tr>
<td>Mitsui &amp; Co (6%)</td>
<td>A trading company providing information, merchandising support, and distribution.</td>
<td></td>
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<tr>
<td>JTB (2%)</td>
<td>A travel agency (formerly Japan Travel Bureau)</td>
<td></td>
</tr>
<tr>
<td>KINOTROPE (2%)</td>
<td>A software firm consulting on Internet business design and systems development.</td>
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In 2001 7Dream had 250,000 members and its biggest sellers were books, CDs (Sony), travel services (JTB) and tickets to various events (PIA, Japan’s largest ticket agent). SEJ’s monthly catalogue at all stores lists travel packages, events and items for sale. Emulating Family Mart and Lawson SEJ has introduced a point card that as of February 2002 had 5 million members. It also has a combination point and IY Bank credit card. (In the summer of 2001, FamilyMart had 500,000 members and had a more extensive list of items for sale.) SEJ sees the number of system users expanding as PC and 3-G phone use of the Internet expands since it can then show more. Customers still want some way to view the product prior to purchase. But even then they will come to the store to pay and pick-up. So this is
an evolutionary process where SEJ is positioning itself to provide full B2C e-commerce nationwide. Presently the MMKs have limited functions such as buying tickets and downloading CDs and games. One cannot access to the Internet or all the catalogue products one can purchase via phone or store. This is one reason sales have not grown as rapidly as expected. Further, prices are a bit high as one pays for convenience. But SEJ expects prices to drop with experience and the number of goods and services sold. So they see this as early in the competitive game. This is true for IY-Bank too, as IY’s and SEJ’s approach is different than other CVS since it owns its ATMs with 3600 installed as of March 2002. Yet, it feels it is fulfilling a definite customer need since the firm’s market research indicates its customers are dissatisfied with banks ‘far from residential areas,” with “limited operating hours,” that do not offer “financial products and services that really meet customer needs.” (IY Bank 2001)

**IY Bank**

Because many customers want to pay for e-Commerce purchases at CVS stores in cash, most CVS have combined their MMK e-commerce strategy with 24-hour ATMs. But as under Japanese law, only banks can have ATMs, the CVS other than SEJ have invited banks to locate ATMs in their stores. The bank though, controls the ATM, so as SEJ wants to manage the services available through their store ATMs, they decided to have their own bank despite the greater capital and systems reporting required. It began in May 2001 with 130 employees and initial capital of Y20.2 billion. IY was the first non-bank to apply for an on-line banking license and was joined in this e-venture by Bank of Tokyo-Mitsubishi, Sanwa Bank, NEC, and NRI as shareholders. Nomura Securities, Nikko Securities, and Sony have joined and three regional banks - Asahi Bank, Shizuoka Bank, and Bank of Yokohama have become affiliated. The shareholding and affiliated banks have provided staff with SEJ, while the bank's president is a former Bank of Japan official. Participation by two securities firms reflects SEJ’s expectation on-line brokerage will eventually be provided. Sony has affiliates offering life and auto insurance and is also planning an e-bank. The participating banks expect to close branches without sacrificing customer service since the ATMs accept different affiliated cards besides IY’s. By the end of December 2001 there were about 2,200 ATMs installed, by March 2002 3600 and by August 2002

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4 In 2002 IY reported: “IYBank was established as a consolidated subsidiary, with the investment of Ito-Yokado and Seven-Eleven Japan on April 10, 2001. Upon receiving a banking license on April 25, 2001, IYBank began operations on May 7, 2001. ... ATM installations are progressing steadily, and IYBank continues to bolster its operational foundation. The bank has aggressively pursued online connection alliances with banks and securities companies to increase customer convenience, and from December 2001 all savings accounts have included network banking functions, which are available over the Internet, cellular phone i-mode service, and push-button telephones. ... As the bank expands into new areas, it will utilize tie-ups with regional banks as well as ATM usage agreements with life insurance companies, credit card companies, and consumer finance companies. ... Total Income for year ended March 31, 2002 was 1,906 million yen ($14,224 thousand). By the end of March 2002, the bank had installed 3,657 ATMs ... and approximately 68,000 accounts had been opened.”
4200 primarily in metropolitan Tokyo. By the spring of 2006 IY will have over 7,100 throughout Japan out of a total of about 160,000 of all types currently installed by all providers.

Services offered will eventually include bank accounts, remittances, money transfers, a debit card within the IY group, credit cards, purchase point cards, loans, Internet banking, and settlement services with member firms such as 7dream.com or Seven-Meal Service. There will be brokerage, insurance and credit cards offered through affiliated firms. Bank accounts, cards and 7.dream have been the main services initially offered. As of March 2002, the bank’s paid-in capital was yen 61 billion and 700,000 credit cards had been issued by the end of August. Installation costs have been about ¥2.5 million per ATM, and because an ATM is a bank branch under Japanese banking rules, accounts can be opened only at a bank branch (or by mail). So SEJ can open accounts only in stores with ATMs. In the first two months (June-July 2001) about 10,000 accounts were opened, and then grew six-fold by March 2002. Besides in SEJ’s CVS, ATMs will be in IY’s other operations. Because IY and SEJ control the bank, they can target services important to clients and can leverage advances in technology since the first ATMs were introduced in Japan. The CVS ATMs are electronically sophisticated and can be programmed to handle a variety of functions as services evolve while being compact, important for storeowners. But SEJ has not yet trained store personnel in these functions. So from a store view the ATMs are presently being used to generate traffic with bank partners handling the service. Still IY Bank customers can access and manage their accounts via i-mode phone, the Internet, or PC.

On this basis they are extending their telematic strategy to the US. As reported in FREE E-NEWSLETTER in January 2003, “7-Eleven(R) Launches National Vcom(TM) Rollout in Orlando; 49 Stores Equipped With Kiosks Offering 24/7 Financial Services.” In this pilot project 7-Eleven, Inc. its US subsidiary will rollout its Vcom combination ATM & kiosk by installing them in 1,000 stores in the US beginning with 49 in Orlando, Fla. The self-service machines offer a touch-screen ATM to provide customers financial and other services 24 hours a day, every day. Thus they are emulating what has already been launched on a larger scale in Japan with a similar IT partnering and telematic based strategy. This has interesting implications for e- and m-commerce development in the US.
Basic Financial Data SEJ FY1996-2002 (February) - not including Hawaii

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<td>1741</td>
<td>1848</td>
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<td>Revenue (yen millions)</td>
<td>239</td>
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<td>287</td>
<td>309</td>
<td>337</td>
<td>358</td>
<td>366</td>
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<tr>
<td>Operating Income (yen millions)</td>
<td>95</td>
<td>103</td>
<td>109</td>
<td>115</td>
<td>137</td>
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<td>Number Stores (Japan)</td>
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<td>7314</td>
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<tr>
<td>Average Daily Sales per store (yen thousands)</td>
<td>662</td>
<td>669</td>
<td>676</td>
<td>678</td>
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<td>29.8</td>
<td>30.0</td>
<td>30.3</td>
<td>30.3</td>
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Source: SEJ Corporate Outline; Brief Summary Results FY2001, Semiannual Report 2003 6 months ended 8/31/02

**LAWSON**

Japan’s 2d largest CVS, Lawson, was established in 1975 a subsidiary of Daiei that went public in July 2000. As of May 2002, it had 7,555 stores in Japan, 69 in Shanghai and 3,548 employees. Reflecting the effects of the recession and intense competition among leading CVS it had expanded only slightly by December 2002 to 7614 Japanese stores plus 96 in Shanghai. Annual sales for FY2001-2002 were yen 1,282.3 billion. In May 2002 average daily visits and sales per store were around 790 customers and yen 478,000 respectively, which did not change much through the year as monthly results fluctuated between 780 and 860 customers and yen 470 to 520 thousand per store. Still, responding to SEJ’s e-commerce challenge, Lawson has developed its own e-commerce system based on the Internet, mobile phones and MMKs that it calls “@Lawson”. Its website www.at-Lawson.com began in 1999.

An affiliate, ECONTEXT, handles product delivery, agency transaction settlements and other @Lawson agency activities. Because this is an open Internet service, its strategy is to add other CVS, gas stations, etc, to the system as payment and pick-up points to give economies of scope. Lawson stores for example are featured on maps in car navigation systems. In May 2001, about the time IY was launching IY Bank, Lawson and a consolidated subsidiary, i-Convenience, initiated i-Lawson, a mobile e-kiosk system allowing customers to shop using mobile phones if they are among NTT DoCoMo’s customers using i-mode. They can order products for delivery at Lawson stores, make payments at Lawson registers using a special connection, and access Lawson’s entertainment services. This m-commerce activity allows customers to use their mobile phones to order products and services
and to connect their phones to a store register to settle bills and receive products ordered over the Internet. Established in October 2000 and capitalized at about $20 million, i-Convenience is an e-retsu between NTT DoCoMo Inc., Matsushita Electric Industrial Co., Ltd., Lawson Inc. and Mitsubishi Corporation, currently Lawson’s largest shareholder. To respond SEJ’s relationship with Sony, Lawson has entered a game software alliance with Nintendo. The goal is to sell video games through Lawson’s online market. Nintendo signed the agreements to counter Sony’s moves with SEJ.

**Loppi multimedia kiosks (MMKs)**

Having begun installing Loppi (“Lawson Online Shopping Print and Pay Information”) kiosks in its stores as early as 1998, Lawson is the CVS leader in installed MMKs. These kiosks, which Lawson sources from IBM, are currently found in all its stores, around 7700. This contrasts with SEJ and FamilyMart that are not yet nationwide and where the respective totals as of summer 2001 were only about 1000-1200 each, though as cited above they have grown rapidly since then, with over 4000 for SEJ by August 2002. Loppi sales, mostly entertainment related, increased 16.5% in fiscal 2000 (end 2/2001) to yen 39.6 billion and the company expected them to rise another 21.2% during fiscal 2001 (end 2/2002). They have leveled off, however, during the first part 2002. Loppi offers many different products and services while providing popular information such as the appearance of a certain band. It has two specific features: an entertainment element for purchasing concert tickets or downloading game software and an information platform element to support payments by customers, such as loan repayments to financial institutions. Tickets for concerts, sporting events, and movies are sold in collaboration with Lawson Tickets Co., Ltd., a consolidated subsidiary. Other LTCL channels are the Lawson and Daiei stores or by phone. In addition, it handles airline tickets and tickets to Disneyland and Universal Studios. In 2001 Loppi launched a hotel booking service in conjunction with JTB. Sales through its Loppi multimedia terminals climbed 92.8% to ¥75,054 million during FY 2001 (end 2/2002), reflecting a continuation of steadily increasing sales of concert tickets via its subsidiary. Boosting sales too were a dramatic increase in demand for billing settlement services. Over time it will integrate its nationwide Loppi network with ATMs and financial services it is now installing. Its E-commerce strategy is to use a combination of clicks and bricks to effectively counter and even surpass SEJ and IY in becoming Japan’s leading B2C e-commerce company. One reason for this belief is Lawson recognized early their entrance into e-commerce began with the development of 3rd party bill settlement services in 1995-96. Their e-commerce initiatives are a direct outgrowth of this and still incorporate it as a feature. These services have grown about 20% per year since. During FY 2000

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5 NTT DoCoMo, Japan’s largest mobile phone firm, had 59% market share and 33.1 million i-mode subscribers in 6/02.
(ending 2/2001) Lawson processed 82 million transactions totaling 650 billion yen. Those 82 million transactions represent store traffic in addition to the small fee made on each transaction. In fiscal 2001, the total value of transactions handled by Lawson, mainly consisting of public utility bills rose 13.9% to ¥743,482 million. Handling commissions were ¥5,689 million, up 7.9% year on year.

Storeowners have an incentive to make this work especially when they own land and the store, where Lawson’s margin is only 34%. This compares to Lawson’s margin of 45% and 50% respectively when Lawson owns the land and the owner the store but leases the land or when Lawson owns both and the franchisee leases them. The scanner records all sales electronically so margin calculations are all done automatically even though the customer pays cash. This is true too for sales through the new MMKs installed in Lawson stores by October 1998. What happens is when a customer makes a travel reservation through the kiosk, buys the right to download music, or purchases as concert ticket, the customer gets a bar coded coupon from the machine. The bar-coded coupon has information on the type of purchase, the amount, and delivery (pick-up at Lawson, mail, or parcel service). He or she then takes the coupon to the counter where it is recorded like any other sale, and the customer pays along with other purchases. This procedure enables Lawson to efficiently handle payments to their 150 partners (actually 500 if one includes credit card companies) electronically using the banking system as an intermediary.

As part of its e-commerce strategy Lawson does not deal directly with the service and goods providers since this would cost it printing and mailing charges. So it tries to be non-paper in using the kiosks, though it has the physical bill record from the bar-coded coupon. Eventually it hopes even this will be eliminated and everything can be electronic, but right now each area still operates independently in terms of supply and service. Strategically Lawson is working with e-tailers so customers can just click and route order and payment, and Lawson does not have to issue the bar-coded bills. In downloading games (Nintendo) and music (Sony), these are handled in the store. Stores are not connected to a central server. Rather each store has the Mother software for the games and then downloads a selected game onto a blank game cartridge or rewrites an existing one. For music, the songs are available in the store and what one purchases is the right to download the music onto a cassette that one brings or buys. Eventually Lawson hopes to have this done centrally online from a central MIDI server just as much Karaoke is done.

The LETSS system explained below hopefully will facilitate these developments. In this way Loppis are both an electronic multimedia platform and a telematic support for 3rd party providers such as
Nintendo and Sony as well as for Lawson’s own business merchandising. Its concert and event ticket company that competes with PIA has been growing about 20% per year until the first part of 2002 and now amounts to 32 billion yen per year and is 2d in Japan. Lawson’s profit on this after only three years was 52 million yen, not including increased sales due to store traffic. Further, its business model is simpler than PIA’s, which sells more events. Lawson targets customers in their 20s and 30s who like music. Lawson then promotes in stores and on delivery trucks special “Glory” concerts that attract perhaps 300,000 fans and for which they control tickets. The idea seems to work, though sales stagnated the first part of 2002 as revenues of 19 billion yen were down 11% and operating income fell 4% year over year. Also, by buying 3% of Nintendo, it has converted this business from a 3d party activity to part of their own merchandising while from Nintendo’s standpoint they have gained a strong e-commerce ally against the Sony-SEJ combo. Lawson has also joined with JTB to offer last minute travel packages unique to Lawson. So while JTB sells travel services through SEJ and FamilyMart, these particular packages can only be purchased via Lawson’s Loppis. They also offer other items but among these varied initiatives, currently entertainment accounts for about 80% of total Loppi related sales. The ECONTEXT affiliate handles delivery and agency related settlements.

**Bricks and clicks**

Like SEJ, Lawson’s e-commerce strategy has leveraged its physical stores and distribution by developing an online catalogue, connected to the Internet so customers can access it via i-Mode phones or PC. Lawson advertises items in newspapers or its stores using posters and paper catalogues. Ads explain how to access the products or services on-line along with delivery information and lead-time for each product or service. Ultimately these will be combined electronically, but it will take until the summer of 2003 or 2004 to accomplish this. Given in FY2000 it sold about yen 40 billion worth of products and services through Loppi with 32 billion entertainment related, its e-commerce activities are growing but not exploding. Lawson thinks they have to wait for broadband and 3-G for this to happen. DoCoMo and J-Phone introduced this at the end of 2002. This is one reason Lawson entered a site access joint venture with NTT DoCoMo, Japan’s largest mobile phone company and the leader in Internet access by mobile phone. It is called i-Lawson and had a membership of 65,000, the largest among convenience stores in Japan in 2001. They hope to establish the standard for Internet connections between convenience stores and i-Mode in terms of how to arrange purchase, payment, and delivery. Once the system is created and is working they hope to license it to other stores and to collect a royalty. Partners in this are Matsushita and Mitsubishi Corp. compared with C. Itoh and Toyota/NTT Data for FamilyMart and Mitsui and NEC/NRI for SEJ. So large CVS seem to be pursuing parallel strategies, though Lawson has believed it is leading. But as we saw above using its
proprietary IT system (Rapp 2002) SEJ has 5 million members in its point program compared to 800,000 to a million for Lawson’s Internet one.

The members of i-Lawson get an IC card and accumulate points for purchases that they can use for discounts on Lawson purchases. Management believes this concept has led to increased traffic, one strategic aim. Other related e-retsu companies include i-Convenience, offering a Lawson m-commerce site 52% owned by Lawson and 18% by Mitsubishi, and e-Context that provides Internet connections, 3rd party payments, and Lawson’s in-store ATMs. Mitsubishi owns 10% of this firm. The ATM operating company is 65% owned by Lawson, 5% Mitsubishi, and 5% each for the banks that own the ATMs. They also have connections with regional banks depending what area each store serves. As of April 2002 there were 2,103 ATMs, mostly in Tokyo and Osaka. It was during fiscal 2001 Lawson enhanced this ability to attract customers by establishing LAWSON ATM Networks, Inc. with 4-major banking groups and several regional banks. By having banks provide the ATMs they save capital, while this company installs them. By February 28, 2002, 1,922 ATMs had been installed and by May 2002, 2,150.

These can be linked with the Loppi multimedia terminals to provide various financial services, improving Lawson’s appeal as a convenient, immediate source of services and keeping it competitive with SEJ and its plans to introduce such services. Plans call for 3,000 stores to have ATMs by the end of fiscal 2002 (2/2003) with eventually all Lawson stores throughout the country having them. This was complemented in February 2002 by creating LAWSON CS Card, INC. with Mitsubishi Corporation and Credit Saison Co., Ltd. to promote a new Lawson credit card, LAWSON PASS, that could compete with IY’s joint card with JCB. According to Lawson, this card business has two main objectives. One is to provide financial services to customers, a new business model through which it can receive interest revenues by providing cash withdrawals to Lawson customers. Secondly, it is an integral part of its customer loyalty program, again similar to SEJ’s approach. LAWSON PASS cardholders receive points for their purchases as well as specials. Expectation is this will build customer loyalty; encouraging store visits. So it feels cards are strategically important for raising customer satisfaction and will also support its e-commerce initiatives by facilitating purchase and payment while building a mineable telematic database. 800000 Lawson cards had been issued by September 2002 with 1 million expected by February 2003. This compares to over 5 million for SEJ even though Lawson started the membership and points concept first. Similar to SEJ, during 2002, i-Convenience, ATM, and ECONTEXT continued in their start-up phases generating operating losses of
211 million, 155 million and 179 million yen respectively on revenues of yen 90 million, 3.1 billion, and 160 million.

Lawson management feels their e-commerce approach is more convenient for customers than SEJ’s as Lawson has more machines (if one combines kiosks and ATMs) in place. But it admits it does not have the same control over the system and are thus not sure when it can add additional financial services such as loans, insurance, or brokerage. So while Lawson has a lead in some e-commerce areas, the winner is not clear. What is clear is the CVS-based e-commerce model is working and growing supported by large firms with real resources. How many US firms can say that? Therefore it is not surprising Lawson’s 2001 and 2002 Annual Reports view e-retailing as important. “In e-commerce and mobile commerce, which include the Internet and NTT DoCoMo’s i-mode mobile service, our store network facilitates Lawson’s existing services-settlement services and product pick-up at stores. We aim to provide these services for a fee to retailers and service providers that sell on line. The key element differentiating Lawson from other chains is our nationwide presence. Clients using Lawson services will thus have access to consumers throughout Japan, unlocking a host of new Net business opportunities. Leading companies have already honed in on our strengths. We have, for example, launched joint ventures with NTT DoCoMo, Inc., Matsushita Electric Industrial Co., Ltd. and Mitsubishi Corp. Indeed, Lawson’s competitive advantage also lies in being able to tap into these companies’ wealth of resources.” (Lawson 2001) But given similar initiatives by its major competitors SEJ and FamilyMart it is less clear whether it will be able to meet the objective to “improve customer convenience and set ourselves apart from other industry chains by promoting e-commerce and financial services.”

**LETSS**

During 2002 Lawson worked in this direction while reflecting the impact of SEJ’s IT and telematic strategy on them and the rest of Japan’s CVS. In FY 2002, Lawson completed a switch to LETSS (Lawson’s Epoch-making Total Strategic System). This is a next-generation online information system that begins to deliver some of the benefits SEJ has achieved over years. In FY 2002, Lawson’s POS registers, store computers and other hardware were replaced, followed by all software. Introduction of new machines and software is expected to improve efficiency in store operations and the speed at which data is processed. Loppis will operate faster and store management systems should be easier to use. System components are designed to forecast demand and better manage ordering. The idea is to pinpoint and forecast customer needs to prevent lost sales. LETSS should to do this by creating planograms tailored to each store, as well as by offering more appealing products and services with
high value added. The competitive test and challenge will be integrating this system with Lawson’s stores and supply structure to achieve organizational evolutionary learning and improvement. SEJ has a 20-year lead of experience and success.

**Basic Financial Data Lawson FY1996-2002 (February)**

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<td>30.3</td>
<td>30.3</td>
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Source: SEJ Company Outline; Lawson 2001 and 2002 Annual Reports; does not include stores in Shanghai

**Bibliography and References available on Request**