Management Interview 01

Introduce and Establish ROIC by Business for Group-wide Reforms.

WAKABAYASHI Hayato

Director and Managing Executive Officer
Senior Executive General Manager, Financial Strategy Unit
J. Front Retailing Co., Ltd.

To transform our portfolio

In order to achieve dramatic growth over the medium to long term, we are working to transform our portfolio by expanding into non-retail businesses such as the Developer Business and the Payment and Finance Business, while "deepening our core retail business" to increase earnings. Portfolio transformation can be said to be an eternal theme for corporate sustainability and growth. We have positioned the Medium-term Business Plan that began this fiscal year as a "phase of change," but it can also be viewed as a time to build a foundation for transforming our portfolio. We must move forward in earnest to invest the funds earned from the currently strong retail business in a focused way in non-retail businesses that can become our core businesses in the future. I believe it is necessary to present both a grand vision from a medium- to long-term perspective and something that can take shape in the short term.

With retail as our core business, our business management has been focused on profit and loss statement for many years. However, since adding the Real Estate Business to the Group, we have made changes to emphasize profitability indicators such as ROA and ROE in order to shift to balance sheet-focused management. Against this backdrop, the Developer Business and the Payment and Finance Business, which aim to expand through portfolio transformation, are characterized by the fact that, unlike the retail business, it takes a long time to recover from investment and that they utilize interest-bearing liabilities.

For this reason, we have decided to shift the focus of our business management to "ROIC," a profitability indicator for "invested capital," which is the sum of shareholders' equity and borrowings. In the cash allocation in the three-year Medium-term Business Plan, we have decided to focus on "deepening retail business" and "growth investment" for the future of the Group. In the first half, we plan to invest aggressively to generate early results in the Department Store Business and the SC Business, and in the second half, we plan to invest in large-scale development projects in the Developer Business. In addition, we have set aside 50.0 billion yen as a growth investment quota to clarify our vision for future growth. Here, too, we will make appropriate decisions based on the concept of "profitable growth," which is based on "ROIC."

Full-scale operation of ROIC by business

We set ROIC targets for each business. First, we calculated the weighted average cost of capital (WACC) for each business by benchmarking it against its peers in terms of business characteristics, and then set a medium- to long-term target for "ROIC by business" that exceeds this WACC by business. We are working to improve business profit by promoting capital investment to maintain and expand our businesses, as well as growth investment with an eye to the future. At the same time, we aim to achieve our ROIC targets by thoroughly implementing appropriate investment management based on growth and profitability.

The targets for "ROIC by business" require a process of estimating the "future balance sheet" for each business. We will prepare and continuously control the balance sheet with the assumption that the Department Store Business and the SC Business will make effective use of the capital accumulated from the past, i.e., equity capital, and that the Developer Business and the Payment and Finance Business will make significant use of interest-bearing liabilities. At the same time, in order to achieve the ROIC targets, it is also important to optimize the amount of equity capital of each company in the Group. By optimizing the amount of equity capital of each company in the Group, we have been able to raise awareness among the management of the Group companies of the importance of balance sheet control and the profitability of invested capital, and by increasing J. Front Retailing's non-consolidated equity capital, we have also been able to improve the "double leverage ratio," which is one of the important indicators for the rating of the holding company.

In this way, the introduction of ROIC can be said to be an initiative that starts with portfolio transformation. Until now, we have used ROE, which is an indicator from an investor's perspective, but ROIC can be said to be a more appropriate earnings management indicator from a company's perspective. Utilizing ROIC is also consistent with our approach to expanding the Developer Business and the Payment and Finance Business from the perspective of "profitable growth." In particular, when calculating ROIC, interest-bearing liabilities are added to invested capital in the denominator, so it is suitable for managing the profitability of non-retail businesses, where the key is how efficiently borrowings are used.

On the other hand, in order for the concept of "ROIC by business" to penetrate and take root, I believe it will need to be carried out with the awareness of a "group-wide reform," taking an approach at the group-wide level that will unite the Group and take a certain number of years. In order to establish "ROIC by business" over the next three years, we launched the ROIC Project in June 2024 and established a system in which the holding company and the operating companies can work together to promote this. We plan to complete the formulation of an ROIC tree for each business by the end of this fiscal year in order to share the challenges we need to address in order to improve ROIC by one point from the previous year. The ROIC subcommittees set up at the operating companies include members not only from the finance division, but also from many other divisions such as business planning.

In addition, we will also promote the introduction of "ROIC by area" in line with the establishment of this "ROIC by business." As the development of the seven key areas progresses in sequence, we will set target earnings levels numerically for each area so that we can explain the earnings levels that reflect the characteristics of each area. In other words, we will be oriented toward the "matrix management with a business axis and an area axis."

Enhancement of business management

In introducing "ROIC" as a business management indicator with the aim of standardizing management control at a higher level, there are important points to consider from the perspectives of both the holding company and the operating companies. For the holding company, the focus is on "business portfolio management" and "stricter investment management," while for the operating companies, the key point is to spread the idea of the profitability of invested capital to business sites by developing an ROIC tree for each business and utilize it in performance management. Business portfolio management will be based on three axes: "ROIC spread," which is the difference between ROIC and WACC, and "future potential," which takes into account the market environment, as well as "sales growth rate." After clarifying the position of each business within the Group, we, as a holding company, will formulate strategic policies and numerical targets for each business. When making investment decisions, we also use ROIC as an evaluation axis and compare it with WACC to ensure that the businesses we invest in are sufficiently profitable and efficient. Then we will add ROIC as an evaluation indicator in post-investment monitoring to control balance sheet so that it does not expand excessively. We also use ROIC as an indicator to guide the direction of withdrawal, sale, etc., taking into consideration factors such as business characteristics, business scale, and market share.

Thus, I believe that ROIC is also effective in strengthening the management of the operating companies. Specifically, for capital investments made by the operating companies that exceed a certain amount, the Investment Project Review Committee examines the investment based on quantitative investment criteria, and plays a role in supporting decision-making at the Management Meetings and the Board of Directors meetings, based on the feasibility of recovering the investment.

Always have multiple scenarios

Furthermore, we have introduced a "phase management" system in which each of the Group's businesses and stores is classified into three phases and managed accordingly, and we regularly conduct business diagnostics based on their ability to generate cash flow in the future. As a result of the diagnostics, for the businesses classified as "Phase II: Caution needed," the relevant operating companies will take the lead in formulating revitalization plans, while for the businesses classified as "Phase III: Considering revitalization or withdrawal," the holding company will take the lead in formulating revitalization plans.

Furthermore, in today's business environment, where uncertainty is growing more pronounced than ever before, it is essential to strengthen risk management, and I believe that it is necessary to thoroughly manage the business operations of the Group, including its operating companies, based on multiple scenarios. In particular, based on the recognition that it is essential for the holding company to always be prepared for risk scenarios, even worst-case scenarios, the holding company takes the lead in formulating plans, including for assessing assets and businesses.

After experiencing the COVID-19 pandemic, I have come to realize once again the importance of having in place multiple scenarios in business management. Securing funds is of utmost importance in order to continue business appropriately even as the risk and worst-case scenarios progress. At the time, some people were of the opinion that we were being overly cautious, but in anticipation of a further deterioration in the business environment, we took a preemptive action to secure 18 months of working capital. I recognize that this was also a measure based on the idea of cash flow management. Assessing non-business assets is another way the holding company is strengthening its risk management. An example is the reduction of cross-shareholdings. As for cross-shareholdings, our basic policy is to not acquire new shares in principle, but to reduce such shares as appropriate based on the validation of rationale for holding them.

Shift the role of finance to be "aggressive"

With regard to shareholder returns, we have decided to raise our consolidated dividend payout ratio from the previous 30% or more to 40% or more, starting in fiscal 2024, aiming to continuously increase dividends by achieving sustainable profit growth. At the same time, we have decided to shift the role of finance to be more "aggressive" than before, with an awareness of improving overall returns to investors, as evidenced by a share buyback of 10.0 billion yen in the first half of this fiscal year, while keeping a close eye on the stock price and balance sheet situation.

As business management becomes more sophisticated, the role required of the finance division has changed dramatically. Until around 2000, it, as a division responsible for accounting and tax affairs, required "practitioners" who could accurately and promptly close accounts, but after 2000, "specialists" were required who were responsible for financial matters such as budgeting and dialogue with investors. Nowadays, the demand is for "strategists" with the expertise to tackle aggressive areas as a company compass. In other words, I believe it is important to shift its role from simply handling so-called "defensive" areas such as account settlement, tax affairs, accounting, and financial operations to "aggressive" areas such as actively participating in management and business strategies, formulating and implementing financial policies, and handling investor relations and other matters.