Foreign Retailers Follow Toys 'R' Us Path To Success

By Hayden Stewart

Teenagers are listening to music at Tower Records in Osaka. Housewives are shopping for baby goods at Toys R Us in Kanagawa. Businessmen are trying on casual wear at Eddie Bauer in Tokyo. Elsewhere around the country, people of all ages are browsing through stores like L.L. Bean, the Body Shop and the GAP.

These scenes of everyday life are a testament to the growing success of foreign-based retailers in Japan. They also provide evidence of how much the country's distribution system has changed in the 1990s.

When then U.S. President George Bush visited in January 1992, Japan's retail distribution was a major issue between the two countries. Toys R Us, a major U.S.-based toy retailer, had been trying to launch operations in Japan since 1989, but its efforts were being thwarted by tight relationships between local toy makers, retailers, and wholesalers.

The American retailer was attempting to import the same high-volume/low-price marketing strategy that it employs in the U.S. Toys R Us outlets there stock an average of 18,000 items at a substantial discount. Low prices are possible because the company circumvents wholesalers whenever possible and uses centralized purchasing to buy directly from makers.

Japanese wholesalers and retailers reacted with hostility when Toys R Us announced its plan to import American-style retailing. Unlike the U.S.-based chain, which boasts average floor space of 3,000 square meters, most Japanese toy retailers are still Mom'n'Pop stores with a few hundred square meters of sales space. They can neither offer the same variety of products nor amass the same level of buying power as Toys R Us.

Japanese toy wholesalers are in a similar situation. Because Japan has few large-scale toy retailers, a multi-layered network of wholesalers has grown up around the small stores. Mom'n'Pop retailers tend to buy small quantities of a product from a local wholesaler, who in turn purchases the goods from another wholesaler (possibly a regional one). In many cases, there are two, three or more layers of wholesalers.

Foreign-based retailers are opening large stores for specialty products like this L.L. Bean outlet in Tokyo. The size of these outlets has been a powerful marketing tool as the large stores can offer a wider selection of goods than traditional Mom'n'Pop retailers.

By late 1991, two years after Toys R Us announced its plan to enter Japan, domestic toy makers were refusing to supply the American company. Toys R Us wanted to sell its goods at 15% to 20% below market prices, and offered to pay local toy makers between 40% and 50% less than suggested retail rates. This was standard for a first-tier wholesaler, yet most toy makers scoffed. They either refused to sell directly or demanded a high wholesale price which would not allow Toys R Us to undercut domestic firms. Nintendo, for one, took the latter route. A spokesman at the time reported to Japan's Nihon Keizai Shimbun, "We have to sell our products to Toys R Us Japan at higher prices than we sell to Japanese wholesalers because we cannot ignore our long-standing relationships."

When the Bush Administration considered the case of Toys R Us, it blamed the Large-Scale Retail Store Law which gives small retailers and wholesalers disproportionate influence over the Japanese market. For instance, this law restricted the hours and days when big stores could open for business. But there were no similar restrictions on the activities of small shops.

Small retailers could prevent firms from opening large stores. Before building a "Category I" facility, which the Large-Scale Retail Store Law defined as a store with a sales area of more than 1,500 meters (3,000 meters in some populous areas), firms had to submit their business plan to the local business regulation council, the local chamber of commerce, and a representative of the Ministry of International Trade and Industry. According to a report by Japan External Trade Organization (JETRO), "The process took between one year and 18 months. Needless to say, this process—difficult enough for Japanese retailers and developers—was seen as an almost insurmountable problem by foreign retailers."

When they did not kill a project, small retailers often forced a change in the construction permit for a Category I store. Says JETRO, "The final permit often included a number of changes to protect local retailers, such as a reduction in floor space."

The Large-Scale Retail Store Law still allows small retailers to restrict the activities of large firms who threaten their business. Yet political pressure, largely from overseas, has seen it relaxed. Local business regulation councils and chambers of commerce are less involved with the review of construction permits. The length of opening hours has been extended, the number of mandatory holidays has been reduced, the period for deciding on a construction permit has been capped at 12 months, and the minimum size of a Category I store has been doubled to 3,000 meters (6,000 in some populous areas).

Toys R Us was ultimately successful in cracking the Japanese market. The company boasts a total of 37 stores and plans to open an average of 10 more per year across the country.

Spokeswoman Tsukagoshi Emiko reports that Toys R Us Japan has succeeded in offering 18,000 different products at discounts of between 10% and 40%.

Amongst the products which Toys R Us sells, about 60% are supplied by domestic makers who are now good business partners of the American retailer. The buying power of Toys R Us is one reason, says Tsukagoshi: "Japanese makers have seen our success."

Securing Japanese products is also easier because discounting is less taboo nowadays. Domestic supermarkets giants like Daiei and Ito Yokado have adopted American-style marketing strategies.

A flood of foreign retailers

Toys R Us is not the only foreign-based retailer to crack the Japanese market. Nearly a dozen other such firms have recently set up shop in Japan.

According to Michael Wheatley, a retail analyst at Jardine Fleming Securities in Tokyo, most foreign retailers do not sell general merchandise, but niche products like music, outdoor goods, and certain types of clothes.

Explains Wheatley, foreign firms face more difficulties when opening a store for general merchandise than one for a niche product. Except for Mom'n'Pop stores, niche retailers tend to have few competitors. They also operate relatively small stores that require less up–front investment.

Wheatley recalls the case of one U.K.-based retailer, Marks & Spencer, which aborted its attempt to built a store for general merchandise in Japan: "The start-up costs would have been very high, because the company would have faced severe competition from Daiei, Ito Yokado, and other domestic retailers. Marks & Spencer would have surely lost a lot of money until it achieved an equivalent economy of scale. One or two stores would not have been enough."

Music retailers

Vendors of compact discs have been one type of specialty retailer to establish themselves in Japan.

California-based Tower Records was the first foreign company to sell records and cassettes in Japan. In 1980, it opened a store in Sapporo. Although smaller than most Tower outlets today, this outlet was then three or four times larger than the usual domestic retail shop.

Keith Cahoon, Tower's Far East managing director, recalls how Japanese labels would not sell to his company in the mid-1980s. Like Japan's toy wholesalers and retailers, they wanted to preserve the status quo. "By stonewalling us, they hoped to drive us out of business."

Tower not only survived, but became one of Japan's largest music retailers by combining top service with high-volume sales of imported LPs and cassettes. "We had an edge over most or our competitors because we were importing music that was not available here and importing titles from the States before they were released here," says Cahoon. Until Tower arrived, works by popular artists came out "significantly" sooner in the U.S. than Japan. A lot of "black" music, including soul, jazz, contemporary Afro-American, and rhythm and blues, was never released in Japan.

Atmosphere was another factor. "When I first came to Japan I went to a record store, and the staff were wearing white shirts and ties," continues Cahoon, "It was like a dentist's office. There was no atmosphere."

The atmosphere at Tower is anything but sterile. Instead of stuffy service, it offers a casual, warehouse-like feeling.

Finally, says Cahoon, Tower fought the competition with convenient opening hours. Many of its outlets were open from 10 a.m.–10 p.m. which allowed customers to shop after working hours. Many competitors (and most department stores) closed around 7–8 p.m.

Over the decade since it launched its first store in Japan, Tower has opened 31 more stores. It imports many of the CDs itself, but Japanese labels like Sony and Warner Brothers are eager to supply the rest. These companies supply both imported CDs from the U.S. and Europe as well as Japanese-made products which now account for 25%–35% of Tower's sales.

In addition to Tower, two firms from the U.K., HMV and Virgin Megastores, have opened 14 stores each and plan to launch many more outlets in the near future. (A major department store operator, Marui, owns 50% of Virgin's Japanese subsidiary.) All three retailers win customers by offering superior service. Paul Dezelsky, HMV's marketing manager, points out how they have installed listening booths where customers can sample music through headphones—a service which domestic stores are just beginning to offer.

Tower, HMV, and Virgin also have comparatively large stores. "The size of an outlet is important," says Dezelsky, "because each must have a wide product range in stock, including back catalogue CDs."

In addition to top service, Tower, HMV, and Virgin offer competitive prices. Although they sell both imported and domestic CDs, the former are substantially cheaper. At HMV's store in Tokyo's Shinjuku Ward, for instance, an imported copy of Mariah Carey's "Daydream" costs ¥1,790. A Japanese-made one is also available for ¥2,300.

Due to their high-quality/low price strategy, the three firms have been so successful that they can now open large stores in prime locations. "When we first came to Japan, we had to make a presentation to the landlords about our company and its history. They would then rub their chins and decide whether there was anything to us," says Cahoon. "Now we have a reputation for drawing crowds of people. When landlords want to generate a lot of traffic, they chase us."

Outdoor goods suppliers

Specialty retailers of outdoor goods and clothes are another brand of retailer to pour into the Japanese market recently. Among this type of company, U.S.-based L.L. Bean and Eddie Bauer are the market leaders.

Established Japanese companies did not oppose the entry of L.L. Bean and Eddie Bauer. Representatives of the companies attribute their smooth entry to having powerful Japanese partners and no domestic rivals.

L.L. Bean Japan opened its first store in 1992 and will soon launch its fifth.

Being a Japanese-owned franchise has helped the company to expand without conflict, says spokesman Tominaga Hideki. Japan's largest retailing group, Seibu, owns 70% and Matsushita Electric holds the remaining stock. "Our parent companies know the rules well," reports Tominaga. "And we know what to do in Japan."

Eddie Bauer Japan, which launched its first store in 1994 and will operate a total of 15 by the end of 1996, has been similarly helped by its Japanese partner. The firm is a joint venture of Otto-Sumitomo, a Sumitomo Group mail-order retailer, and Eddie Bauer U.S.A.

An absence of established competition is the other factor which explains the success of these companies. Says Tominaga, "Our company's products are unique. No one is threatened by us."

L.L. Bean took off when teenage girls turned to outdoor wear as street fashion. "But town fashion is changing to a more feminine look, including short skirts and long boots," remarks Tominaga. As a result, L.L. Bean is targeting people between 25 and 40 years old, whose tastes are relatively stable.

Eddie Bauer's manager of Store Development, Nomoto Akira, echoes this strategy. Young adults are enjoying more free time, he says, and many companies are advocating "casual Friday," when businessmen can wear any style of clothing to the office. "Because of changing lifestyles, the demand for our products is very strong."

Team up or go alone?

The contrasting experiences of Toys R Us, Tower Records, L.L. Bean, and Eddie Bauer raise an important question for would-be entrants to the Japanese market: whether to team up with a domestic firm or open a wholly-owned Japanese subsidiary.

Wheatley of Jardine Fleming Securities agrees with Tominaga of L.L. Bean and Nomoto of Eddie Bauer: linking up is often the best way.

"Forming a joint venture or a franchise allows you to start faster," concedes Tower's Cahoon, "but it might not be in your long-run interest. You may lose control of the company and/or your partner's agenda may diverge from your own."

Whether one links up with a Japanese company or stands alone, would-be entrants should bear in mind that Japan is not an easy place to do business. In addition to regulations and the possibility of resistance from local firms, land and labor costs are high.

On the other hand, Japanese employees are well educated, staff turnover is not a problem, and crime is minimal. Most of all, Japan is a major market. In the music industry, for example, HMV's Dezelsky points out that CDs are cheaper in Japan than in any other major country, if one compares their value to the general level of prices and wages. Even teenagers can snap up CDs, making Japan the world's second largest market for music with annual sales in excess of US$5 billion. JJTI

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