Keio Business School

Rakuten, Inc.

〈a〉 From Foundation to Growth Phase

Founding of Rakuten Ichiba

In early 1997, a company called MDM was launched in an office building in the Atago district of Tokyo. MDM stood for “Magical Digital Market,” and was suggestive of the “rakuichi/rakuza” free markets policy in Japan around the 16th century. The company started with capital of 20 million yen and five employees.

“If I only get one life, I want to do something new.”

President Hiroshi Mikitani’s idea to launch the business was prompted by the loss of his uncle and aunt in the Great Hanshin Earthquake two years earlier. After graduating Hitotsubashi University with a commerce and management degree, Mikitani had worked for the Industrial Bank of Japan (IBJ), but decided to quit his life as an ordinary salaryman.

At IBJ, he assisted in the mergers and acquisitions (M&As) of SoftBank, and was blessed with the opportunity to experience firsthand the venture management of SoftBank’s President Masayoshi Son. On top of this, around this time, the Internet was beginning to attract attention, and his friends in the U.S. from his student days at Harvard Business School were starting up their own businesses one after another. This also encouraged Mikitani to do the same.

In the autumn of 1995, Mikitani established a consulting firm called Crimson Group and set about developing a business plan. Also at this time, Mikitani happened to meet Shinnosuke Honjo, a graduate student at Keio University’s Shonan Fujisawa Campus (SFC). Honjo was hoping to get a job at IBJ, and thinking what better way to learn about the inner workings of the bank than talking with someone

This case was prepared as a class handout by Takashi Yamane, Keio Business School, based on publicly available materials (June 2010).

who had quit the bank, he paid Mikitani a visit via an introduction.

Honjo had in fact sparked the online job-hunting movement, creating a web page at SFC about all the things wrong with the battle among job seekers to find employment. When Mikitani learned of this, he asked Honjo's opinion about his own business plan, and Honjo turned his interest to this instead of IBJ. It was this collaboration to start up an online company that was the beginning of Rakuten.

Honjo's view was that to really take advantage of the Internet, costs had to be kept low and systems kept simple.

They developed a system that allowed vendors to choose what they sell and change their own prices, and set a flat site charge of 50,000 yen (at the time). Their thinking was that this would eliminate the need to keep track of each store's sales and that vendors would benefit from higher sales.

In the U.S., Amazon.com was gaining popularity. It purchased and sold books, and had its own logistics network. But Rakuten decided that they would also leave logistics up to each store. They felt that a "no touch system" would be more efficient—they would instead devote themselves to developing systems to attract customers.

"Why don't you sell your raw oysters on the Internet?"

Once he had finished building the system, Mikitani busied himself securing vendors. Unique sells better on the Internet. During his wide-ranging search, he came upon across a raw oyster in a magazine that was described as "easy to open" and phoned the seller.

The seller was a person working in tourism development in Ise-Shima. He had been interested in selling online for some time, but had been unsure of exactly how to proceed. Mikitani explained that once the seller opened a store on Rakuten's marketplace, he could begin selling online right away. He would not need his own server, and the required knowledge was no harder than word processing. This was appealing to the seller.

Thus, the virtual shopping mall "Rakuten Ichiba" was launched in May 1997 with 13 stores.

The 13 stores also included some major companies such as Tokyu Department Store and Nikko Shoji (JAL Trading). The man who introduced Mikitani to such companies was Muneaki Masuda, president of Culture Convenience Club (CCC) which operates the TSUTAYA chain of video rental stores.

After handling SoftBank's M&As while working at IBJ, Mikitani had assisted in negotiating the partnership between CCC and DirecTV, a satellite digital broadcaster in the U.S. This connection led Mikitani to approach Masuda for advice as a veteran venture capitalist.

Aided by this peripheral support, by the summer of the following year, Rakuten Ichiba had grown to more than 200 stores. It was around this time that an NHK news commentary program described Rakuten Ichiba as "Japan's largest e-commerce (EC) mall." Furthermore, in June 1999, Rakuten Ichiba was voted number one in the online shopping category of a readers' choice ranking of popular websites published by Nikkei Net, the online edition of The Nikkei newspaper.

The EC Mall Market

1997–2000

From about 1994, there was a flurry of EC malls being launched by different types of firms, including large financial think tanks, trading companies, and printing companies. However, not all of them were successful.

Possible reasons for this were:

- Information is out of date and boring
- Firms are forced to make a large initial investment to open a store
- Online stores cannot be maintained without a network specialist
- Agency fees are charged as a percentage of sales

The biggest factor underlying "information is out of date and boring" was thought to be that the systems did not allow vendors to change their own website information. Each time they wanted to change the information, vendors had to send a request to the mall administrator, and this took time. Moreover, the vendors had to pay a fee each time a change was made.

Vendors were also forced to make a large initial investment. The major companies running the malls had set a site charge based on the aggregate of their operating costs, so naturally, subscription fees and site charges were expensive.

Below is a summary of the conditions for opening a store on these shopping malls.

- Initial cost when opening a store: 500,000–2,000,000 yen
- Monthly site charge: 300,000–1,000,000 yen or more
- Requires dedicated personnel who are proficient in the software
- Requires time, money, and skill to create the site
- Must send a request to the mall administrator when adding or changing displayed products or images
- The system used by customers to place orders needs to be designed for each store

In contrast, with Rakuten Ichiba, the mall operator only provided a system and a venue. The retailers, farmers, or businesses that were opening an online store were able to operate their own "stores." The system meant that all vendors did their own editing work on the website, such as replacing products and changing images.

The first step in opening Rakuten Ichiba was development of the Rakuten Merchant Server (RMS). In 2000, the RMS had the following four main functions.

Functions of the RMS

(1) R-Storefront: Web page editing function

Vendors can do everything simply by themselves on a computer without the need for technical knowledge, from creating their own shop and web pages to updating the design and product lineup.

(2) R-Backoffice: Customer orders and customer management function

Orders and shipping, etc. are managed online. A database of transactions is created automatically, allowing for data management of orders, customers, products, sales, etc.

(3) R-Transact: Marketing analysis function

Access counts are kept, and access can be analyzed by different time periods and by product. The routes taken by consumers to get to the store can also be analyzed, along with customer demographics.

(4) R-Mail: Communication support function

Bulk emails can be sent to customers who have purchased at a store before.

Venders were supposed to attend a two- to three-hour workshop before opening their stores to receive training on how to use the RMS. In November 1999, Rakuten University was launched with lectures delivered by Rakuten staff, including on “Secrets of Success for Internet Shops” and “Making the Most of Auctions.” At the same time a response service via phone and other means was also offered to vendors.

When opening a store on Rakuten Ichiba, there were no particular initial costs, and the only charge was a fixed monthly site charge (which needed to be paid in advance in six-month installments). There were three tiers of monthly site charges depending on the number of products carried by the store. A store carrying up to 500 products was called a “small store,” and the monthly fee was 50,000 yen. The fee for a “regular store” carrying up to 1,000 products was 100,000 yen per month, and the fee for a “premium store” carrying up to 2,500 products was 250,000 yen per month.

In 2000, the makeup of stores was: 90% small stores, 9% regular stores, and 1% premium stores. It was an attractive system for small stores.

After observing the success of Rakuten Ichiba, competitors followed suit, launching similar malls one after the other. Japan Telecom started a shopping mall called Townlink, adopting a fee structure and vendor services similar to Rakuten Ichiba. ASCII operated the ASCII Rapid Commerce Service (ARCS), and had the advantage of being able to introduce products in its 14 PC magazines and six gaming magazines, as well as in multimedia catalogs (CD-ROM) attached to the magazines. NEC opened Web Shop in the Cyberplaza on its BIGLOBE website and had more than 200 stores.

Netprice, operated by CyberAgent, and So-net, operated by Sony Communication Network Corporation, which was also an Internet provider, raised the profiles of their respective shopping malls by running extensive spot commercials on TV.

The entry of Japan's largest portal site operator, Yahoo Japan, was also seen as a threat to Rakuten. Rakuten launched Rakuten Auction in July 1998 and Rakuten Furima Auction (Rakuten Flea Market Auction) in September 1999 as a new trial of buyer participation in malls.

As of August 1999, Rakuten had 25 employees and about 1,000 stores on Rakuten Ichiba. Across the whole mall, a total of about 93,000 products were available for sale and monthly sales were about 500 million yen. In terms of the access count to Rakuten Ichiba, the mall reached 16 million page views[1] (PV) per month, meaning that products were being sold once every 160–170 PV.

As of March 2000, there were about 2,500 stores, about 200,000 products across the whole mall, and monthly sales had reached approximately 1.5 billion yen. The number of subscribers to the Rakuten News newsletter also rocketed from 220,000 (in August 1999) to approximately 650,000.

In the fiscal year ended December 31, 1999, Rakuten achieved net sales of 553 million yen (four times the previous year) and an ordinary profit of 228 million yen (seven times the previous year). Rakuten had 130 employees and the monthly access count had reached 130 million PV. In April 2000, Rakuten went public through an initial public offering (IPO) on the over-the-counter (OTC) market, raising 49.5 billion yen in capital. Market capitalization based on the initial share price at the time of the IPO increased to approximately 400 billion yen.

The rapid growth continued, and by August 2000, there were about 4,000 stores and 451,000 products across the whole mall.

At the same time, many of the stores on Rakuten Ichiba were in the same industry, so problems began to surface of stores dropping out that were not able to keep up with the competition and an increasing number of stores remaining open but doing virtually no business. As of 2000, there were approximately 500 stores that were open but no customers were visiting.

Introduction of New Fee Structure, 2002

In April 2002, Rakuten changed the fee structure for vendors. It stopped its previous flat-rate system and introduced a pay-as-you-go fee. Vendors with monthly sales of up to 1 million yen could continue using the market as before by paying only a basic fee, but an additional fee of 2–3% was imposed for any amount above this. For vendors with large sales, this meant a substantial increase in their site charges.

In May of the same year that the new fee structure was implemented, the number of store closings exceeded the number of store openings by 58. Thereafter, however, the net change was positive, so the

[1] Page view: A request by a user to display a single page on a browser. In other words, each HTML file is counted as one page view.

impact of the real price increase was seen as negligible.

"I knew from the time Rakuten was founded that the flat-rate system would need to be amended at some point. Even if the number of stores halved, I was prepared to push through with the change." (President Mikitani)

The total value of transactions on Rakuten Ichiba reached 75 billion yen in fiscal 2002 (an increase of 43% from the previous year). This was equivalent in size to the sales of a single department store in Ginza, Tokyo. According to a survey of commerce, retail sales in Japan were down year-on-year for every month in fiscal 2002, but by contrast, Rakuten Ichiba was doing well. Some vendors, like wine merchant Winery Izumiya, saw their monthly online sales approach tens of millions of yen, surpassing the sales of their brick-and-mortar shops.

"Online markets are absorbing demand from real stores, such as department stores and consumer electronics mass retailers."

"Rakuten's long-term goal is to achieve total transactions of 1 trillion yen. (Omitted) If we can achieve this goal in about 10 years, I think we will be able to create a new trend in the Japanese economy." (President Mikitani)

Change in Sales Style

Coinciding with the introduction of the new fee structure, Rakuten also changed its sales style. Whereas previously Rakuten had simply responded to questions from vendors, it now provided consulting services to stores via telephone. The Sales Division was responsible for the consulting services and had about 60 employees at the time (out of a total of 290 employees). President Mikitani positioned this period as the "Second Foundation," and also took on the role of General Manager of the Sales Division.

In March 2002, Rakuten adopted a company system and executive officer system, and reorganized its business operations into seven companies in order to clarify responsibilities and promote efficiency while strengthening cooperation within the Rakuten Group.

Below its business companies, Rakuten established the Development Division in charge of new store acquisition and the Sales Division, which provided a consulting service to stores. Below the Sales Division were the Marketing Department, the Start-up Department, which provided support for stores in their initial phase, and five other departments, one for each category of products. Clothing, computers and consumer electronics, and food are the three categories on Rakuten Ichiba with the most stores and the most transactions. The Gourmet Department, IT Department, and Fashion Department were set up as dedicated departments with the aim of gathering sales know-how. Other categories were grouped together and managed by the Sales Promotion Department 1 and Department 2, and EC consultants（consultants from Sales Division called EC consultants）were assigned to each specific product category.

Every morning, daily reports were distributed to the EC consultants. They contained the previous day's sales and various other data for the stores they were responsible for. Starting in October 2002, monthly store operations reports were also distributed to vendors. These contained the targets set by the vendor, the target achievement rates, and a comparison against other stores in the same category that were performing well. Using these data, EC consultants provided advice to vendors, including suggesting the frequent mailout of sales promotions. Each EC consultant was responsible for about 100–150 stores, and would make and receive as many as 40 phone calls every day.

The Start-up Department was responsible for stores during the first three months of opening. They provided support to vendors for "store opening sales," for example, placing free gift ads on the Rakuten website, collecting the email addresses of prospective customers, and publishing email magazines containing information on new products.

The Marketing Department produced special web pages for hot products and seasonal events, such as Christmas and Valentine's Day, creating opportunities for vendors to gain exposure. At the end of 2002, Rakuten also trialed distributing advertisements with prices in Tokyo and Osaka with a focus on consumer electronics listed on Rakuten.

"Previously, even though we wanted to put more effort into supporting existing vendors, we were always concerned about the number of new stores and the number of advertisements acquired—two figures that were directly related to Rakuten's business performance. With the new fee structure in place, the support we provided helped improve vendor sales, which linked directly to Rakuten's profits. It also became clear what we needed to do to become more highly appreciated within the company. I think that was the biggest change." (Department manager)

Systems were also introduced for EC consultants to share their acquired know-how throughout the company, rather than keeping it internalized. As well as being assigned to a department responsible for specific product categories, EC consultants were also randomly assigned to one of five interdepartmental teams. Each week, the results for each team were aggregated, and rankings of sales growth rate were announced at general meetings. Through these "intellectual battles," Rakuten made conscious efforts to promote the exchange of know-how beyond organizational and product boundaries.

Expansion of M&A after Listing

Mikitani had been thinking, "We have to quickly regenerate into a comprehensive portal site."

One manifestation of this was Rakuten's acquisition of Infoseek Japan, a search engine operator that had been a rival to Yahoo Japan.

Rakuten had been listed on the OTC market in April 2000, raising close to 50 billion yen. With these funds, Rakuten acquired Infoseek's local subsidiary in Japan at the end of that year for approximately 9 billion yen.

The timing of Rakuten's listing was pure luck. On April 19, the day that Rakuten was listed, shares in dot-com companies that had been soaring on the U.S. Nasdaq Stock Market fell, and shares in the benchmark Amazon.com were sold off heavily. It was the beginning of the end of the so-called dot-com bubble.

Rakuten continued to acquire companies. One of its major acquisitions was the takeover of MyTrip.net, which operated the largest travel website in Japan, "Tabi no Madoguchi," in September 2003. The acquisition cost of 32.3 billion yen was the highest ever for a dot-com acquisition in Japan at the time. The net assets of MyTrip.net were a mere 1.3 billion yen, meaning that goodwill amounted to 31.0 billion yen. (In the fiscal year immediately prior to the acquisition (the fiscal year ended March 31, 2003), MyTrip.net recorded net sales of 3.2 billion yen and net income of 550 million yen.) People were amazed at this sum of money.

Rakuten then acquired Internet securities firm DLJdirect SFG Securities for 30.1 billion yen in November 2003. For the fiscal year ended March 31, 2003, DLJdirect had recorded net sales of 6.0 billion yen, a net loss of 300 million yen, and net assets of 4.0 billion yen, meaning that goodwill amounted to 26.1 billion yen. Again, people were surprised by the extravagant purchase.

The acquisition was a come-from-behind bid by Rakuten, outbidding other companies that had preceded it. It is said that Sumitomo Mitsui Banking, which has strong capital and business connections with both companies, had a strong hand in the decision.

Still, some rival Internet securities firms adopted a cynical view, saying, "Rakuten's customer base and DLJdirect's customer base are too different."

However, DLJdirect President Atsushi Kunishige commented, "We want to give a boost to new accounts." As a result of coming under the wings of Rakuten, Sumitomo Mitsui Banking's shareholding fell below 5%, the threshold at which banks engaging in the securities business are regulated. Unrestricted by the Banking Act, DLJdirect was now free to roll out advertising and do other things on its website.

In addition, services could be launched allowing customers to use points received from DLJdirect for purchases on Rakuten Ichiba, and a contact point was able to be set up on Rakuten's existing web page for users to open securities accounts.

"I would like to explore financial services that can be brokered online, such as payment services and banking, not just securities." (President Mikitani)

Underlying this was also the view that the primary interface for retail finance would shift from face-to-face at brick-and-mortar financial institutions to online, where it is easier to keep fees down.

For this reason, many individuals from retail loan companies and banks joined Rakuten to launch installment financing and credit services targeting high-value purchasers on Rakuten Ichiba.

Rakuten was also eyeing corporate customers, for example providing loans to vendors on Rakuten

Ichiba. If Rakuten's consumers and vendors could be enticed, the finance sector could become a major source of revenue for Rakuten.

However, there are challenges associated with expanding into the finance sector: business results are more susceptible to market fluctuations and large amounts of debt make the consolidated balance sheet liable to becoming unstable. It becomes a question of how to stabilize overall consolidated earnings.

Entry into Professional Baseball and Growth of Online Shopping

At a meeting of professional baseball team owners in November 2004, it was unanimously decided that the new team to join the Pacific League the following season would be Rakuten. It was the first entry of a new team into professional baseball in half a century, and of course, the first entry by an IT or Internet-based company.

The name of the new team was the Tohoku Rakuten Golden Eagles and they were to be based in Sendai City. Competing for new membership into the Nippon Professional Baseball (NPB) were Rakuten and Livedoor (President Takafumi Horie), both Internet-related companies.

Takuo Takihana, owner of the Yomiuri Giants and chairman of the meeting of baseball team owners, explained the reason for their selection, "We would prefer a stable company that is capable of managing the baseball team for the long term." He emphasized that Rakuten outshone Livedoor in terms of corporate size and strength, based on the judgment that, initially, it would be necessary to manage the team while enduring losses. However, there were some who questioned the decision to select Rakuten, which had been posting deficits since being listed, whereas Livedoor, at the time, was a company with ample deposits and savings and which had been operating in the black.

President Mikitani stated, "IT companies branching out into professional baseball is a trend of the times," and he expressed his eagerness for a new kind of management for professional baseball teams, including the building of a business model that takes full advantage of the Internet. Although Rakuten started later than Livedoor in applying for membership and deciding on a home ground, it gained the support of existing baseball teams by having heavyweights from the business community as members of its Management Advisory Committee, including Hiroshi Okuda, who was chairman of Toyota and chairman of the Japan Business Federation (Keidanren). President Mikitani and Chairman Okuda were both graduates of Hitotsubashi University and shared a close relationship. Perhaps because of this relationship, in November 2004, Keidanren approved Rakuten's membership as the first dot-com company to join the federation.

Online shopping was also expected to continue growing rapidly.

According to a survey by the Ministry of Economy, Trade and Industry, the scale of Japan's B2C online shopping market continued to grow at a high double-digit rates year-on-year, reaching over 6 trillion yen in fiscal 2008 (including travel and services; or 2.9 trillion yen excluding these).

Amid the Livedoor Fracas, Rakuten Also Approaches Fuji Television and TBS

In the afternoon of April 18, 2005, Fuji Television Network (Fuji Television) and Livedoor reached an agreement to settle their dispute over plans to buy a stake in Nippon Broadcasting System.

Originally, Fuji Television had announced a takeover bid (TOB) for the shares of Nippon Broadcasting System, Fuji Television's major shareholder. However, on February 8, Livedoor announced that it had acquired a major stake in Nippon Broadcasting System in after-hours trading on the Tokyo Stock Exchange. Since then, the media had been in an uproar.

As a result, the amount of funds paid by Fuji Television to Livedoor, including for an allotment of new shares in Livedoor, amounted to 147.3 billion yen.

Behind the scenes of this Livedoor fracas, Rakuten had also actually approached Fuji Television. However, Livedoor had beaten them to it.

On March 10, 2005, Rakuten announced that it would acquire Kokunai Shinpan—an unlisted, second-tier credit sales firm—from a Mizuho-affiliated revitalization fund. It was Mizuho Corporate Bank that brought the deal to Rakuten. What is more, it was a proposal brought directly from the president of the bank, Hiroshi Saito.

"I get to collaborate with President Mikitani again."

At a press conference on the sale of an investee company by a bank-affiliated fund, that the president of that bank to also be present, smiling from ear to ear, was described as extremely unusual.

Mikitani and Saito had been in a subordinate-supervisor relationship at former IBJ (currently Mizuho Corporate Bank). Before that, Saito had been the Tokyo branch manager who had supported talks of partnership between CCC and satellite digital broadcaster DirecTV—a partnership that Mikitani had been working on during his days at IBJ.

Ten years before the press conference, when Mikitani jumped ship from the bank intending to start his own business, it was his direct supervisor, Saito, who had tried to keep him on board.

As for the approach made by Rakuten toward Fuji Television, it is said that Mizuho had prepared finance in the hundreds of billions of yen.

"Fuji Television is not the only key station in Tokyo."

As revealed by a source close to Rakuten, Mikitani was reportedly in frequent contact with executives from several other stations besides Fuji Television.

Then, in October 2005, Rakuten announced that it had increased its stake in Tokyo Broadcasting System (TBS) to just over 19%.

"By adopting a holding company structure, I want to complement the businesses of our two companies while maintaining their independence. We can form a world-class media enterprise group." (President Mikitani)

However, speaking at a press conference, TBS President Hiroshi Inoue expressed his displeasure. He subsequently kept refusing to discuss the matter with Rakuten, leading to an enduring stalemate.

Eventually, the dispute would be settled in 2010 by TBS buying back its shares. Under the amended Broadcasting Act, which came into effect in 2008, a system of certified broadcasting holding companies was introduced whereby a single shareholder could only hold up to 33% of voting rights. TBS made use of this change as a takeover defense to thwart Rakuten's scheme.

Rakuten had invested a total of about 120 billion yen into TBS shares, but the purchase price arbitrated by the Tokyo District Court meant that Rakuten's loss amounted to about 70 billion yen (of which Rakuten recorded 65 billion yen as a valuation loss in the fiscal year ended December 31, 2008).

During this time, TBS was not only forced to allocate a large amount of money to the share buy-back, but also experienced a decline in advertising revenue and was beaten in the competition for ratings by other commercial broadcasters. Whereas some said that the Rakuten issue had diverted management's focus, one executive in Rakuten said he felt that President Mikitani, who had been running at full tilt, had come to a sudden stop.

Criticism of M&A, Backlash from Vendors

In the eight years since its founding, Rakuten had poured a total of about 100 billion yen into about 30 projects.

Considered as a rival to Rakuten, Yahoo Japan had expanded its services almost entirely on its own by unifying almost everything (including its search engine, auctions, and virtual shopping mall) under "Yahoo!" and using its portal site, with its overwhelming power to draw customers, as a gateway. Yahoo Japan also overwhelmed Rakuten in terms of profitability, with a ratio of ordinary profit to net sales of around 50%.

SoftBank President Son said this about Rakuten and Livedoor:

"They are miniature SoftBanks."

"Mikitani has a sense of balance that we don't have, which he acquired through his life as a salaryman. It's very hard to imitate. Now, if Yahoo were to get serious, Rakuten would..."

Once claiming to be an "Internet zaibatsu," President Son's SoftBank has become a major shareholder of companies like Yahoo Japan, and uses their unrealized profits to maintain its financial standing. It has also profited from major acquisitions and sell-offs.

There were other concerns about Rakuten's growth. In the virtual shopping mall, which is the foundation of Rakuten, quite a few stores were opposed to the strict control being exercised by Rakuten over its member stores.

The email addresses of customers who shopped at stores on Rakuten were not disclosed to the vendors. The vendors could send out promotional emails to customers via Rakuten's system, but could not take any accumulated customer information with them when they shut up shop.

On the other hand, the Rakuten Group clearly stated that customer information could be used for its own business purposes.

Rakuten's explanation was that, in the wake of customer information being leaked from SoftBank, "The purpose is to ensure that personal information is protected." However, the vendors believed that "This is just a front. The real intention is to dissuade the better stores from leaving" (president of one vendor company).

Many of the mall vendors had a strong sense that customer data also belong to them. If not, they wouldn't have paid money to Rakuten .

In fact, the better stores had implemented various sales promotion measures, such as distributing email magazines and making use of competition websites and advertising.

Thus, there was a considerable gap between this view and President Mikitani's perception that "customer data is Rakuten's asset." According to the assessment of one domestic securities analyst, "Rakuten's system is already a success story of a franchise chain in which 'franchisees are unable to rebel even if they want to.'" He warns, however, "That also assumes that growth continues. If growth is halted even once, vendors will have more say, and Rakuten may be forced into changing its revenue structure."

Many of the stores that are disgruntled with Rakuten say, "If there was another mall that could compete with Rakuten, we'd switch allegiances anytime."

Rakuten continued to negotiate with the stores on Rakuten Ichiba for a revision of fees. Then, in 2005, Rakuten changed to a system in which stores with net sales of 1 million yen or less, which were only paying a monthly site charge of 50,000 yen, were charged an additional pay-as-you-go fee of 4% of sales.

In April 2002 when fees were increased (when a pay-as-you-go was introduced for stores with monthly sales of more than 1 million yen), some disgruntled vendors shut up shop. But this time, "There had been hardly any complaints." (President Mikitani)

One variety store owner commented, "If we were to quit the reliable Rakuten, our customers will decrease dramatically. Rakuten manages the credit card numbers and other information, so our only option is doing business on Rakuten."

Rakuten Travel similarly notified its vendor inns and hotels about major changes in the contract terms and conditions starting in September 2005. The three terms and conditions were as follows:

(1) Hotels and other accommodation facilities will always provide a certain number of rooms to Rakuten, even during the peak season

(2) The margin paid to Rakuten (the total of system usage fees and point rebates to customers) will rise from the current 6% to 7–9%

(3) Vendors must not sell via other channels at a lower price than the terms provided to Rakuten Travel

In response to this notification, the Japan Ryokan Association and the Japan City Hotel Association passed resolutions remonstrating and demanding that the contract be revised and withdrawn. Rakuten Travel stated, “We would like to explain further so that they can understand,” but the discord intensified.

Some companies declared that, while business was good on Rakuten, “We don’t need Rakuten anymore.”

The catalyst for these declarations was the rise of the Google search engine. More traffic was coming to vendor web pages via keyword searches on Google, such as “cheap, imported furniture,” than from Rakuten’s web pages. Sites that rank highly in Google keyword search results are those with the most visitors and the most inbound links. Vendors had realized the convenience of Google’s ability meant heavy users could search for highly accurate information, so its popularity was skyrocketing.

Others had the following to say:

- “As ordinary users become more proficient at using Google, the need for middlemen portal sites like Rakuten will be eliminated.” (Think tank researcher)
- “Rather than paying money to open a store in a mall, we’re better off bringing customers directly to our website by devising ways to raise our profile in search results.” (Exiting Rakuten vendor)
- “Rakuten has many vendors in the same industry, so depending on the product, we tend to get caught up in a price war.” (Rakuten vendor)
- “Rakuten is overflowing with so much stuff, and although merchandising is important for a store to become popular, we’ve come to realize that those of us who originally operated real brick-and-mortar stores know more than they do. So, we’re thinking of shutting up shop.” (Rakuten vendor)
- “The pay-as-you-go fee is tough for venders with monthly sales of 1–5 million yen.” (Rakuten vendor)
- “It was good at first, but now we’re timing when to leave Rakuten.” (Rakuten vendor)

President Mikitani Discusses the Future of Rakuten (interview transcript)[2]

“Capture 10% of consumer spending!”

(Question: What kind of company is Rakuten? What does it aim to become?)

“What kind of company you ask? I wish I could tell you (laughs). E-commerce has not simply displaced distribution channels; it has dramatically changed the structure of our economy, right. (Omitted) So the information revolution is a distribution revolution, and it also changes how marketing

[2] Interview transcript from the August 25, 2008 issue of *Nikkei Business.*

is done. This being the case, it makes no sense to define what a company is in terms of some existing industry.

"From the point of view of consumers, as you might expect, for us, the important thing is the membership business—understanding members and providing them the services they need. The distribution business is incredibly important as an initial step in this.

"Our basic philosophy is that 'shopping is entertainment.' In other words, the age of doing business based solely on the appeal of low prices is over.

"Rakuten is a venue of communication where consumers buy things while interacting with individual store owners. With Rakuten, the leading role is played by the store manager, whereas with Amazon.com, products play the lead. With Ito-Yokado too, the products are probably the star of the show. What we're about is reviving the good old shopping malls, but online. I reckon that it is because of this kind of communication that people buy things and that they are moved by that experience.

"On the other hand, from the perspective of suppliers, our mission is to energize small- and medium-sized enterprises, and that's what makes us different from Amazon and other major websites. This is why Rakuten is so universally received and so many store owners open stores on Rakuten.

"Of course, since it's a marketplace, basically everyone is welcome. In fact, we've got major companies, such as Seiyu, Takashimaya, and Miki House, that have also opened stores on Rakuten. But I really don't want to be just pursuing the majors. Where would be the fun in that?

"I'm not interested in a direct management business where we select specific products and hold inventories. We just let them do what they're good at. At the end of the day, there are limits to individual judgment. Some things I thought would never sell are in fact selling like hotcakes. Unexpected and unimaginable things.

"Rakuten Books, however, is directly managed. We've no choice here because there are no bookshops capable of handling 2 million books. The mall business will forever remain our core business. When I think about diversification of consumption, I don't think we'd ever get that big if our business model was focused on a single company.

"So what is at Rakuten's core? Basically, it's a marketplace that satisfies the various needs of suppliers and consumers, where we provide high value-added services to our members.

"In terms of the economic sphere of our membership business—apart from Rakuten Ichiba—Travel, Securities, and Card are also important. They're all connected.

"If you ask me if our current sales ratio is reasonable, I'm not sure. We're just trying to get everything together that we think is necessary for Rakuten members: consumption, investment, and savings. All we’re doing is building an online town.

“I think total consumer spending in Japan is around 170 trillion yen. Of this, I reckon maybe about 30% at most could be substituted with online spending. And of this, I’d like Rakuten to capture 30% of the distribution. But that’s a long way off. It’s like asking a child at kindergarten what they want to do after graduating university. It’s taken 10 years to get to this point, so maybe we’ll reach that level in another 10 or 20 years.

“In terms of gross merchandise sales generated by our entire Group—Rakuten Ichiba, books, travel, and finance—we have already attained 1 trillion yen, so I’d expect to reach at least 2 or 3 trillion yen in about five years or so.”

[Questions]

(1) Going back to 2000 when Rakuten Ichiba created the foundation for Rakuten’s growth, analyze why Rakuten Ichiba was successful (strengths) and what were its problems (weaknesses).

(2) How would you evaluate the changes made to the fee structure and management system in 2002?

(3) How would you evaluate the subsequent acquisitions and other management developments undertaken by Rakuten through to 2005?

Appendix 1

History of Rakuten (1)

Date	History
February 1997	MDM, Inc. is founded
May 1997	Rakuten Ichiba begins service
June 1999	Company name changed to Rakuten, Inc.
April 2000	Rakuten registers shares with the Japan Securities Dealers Association as OTC stock (JASDAQ)
September 2000	Rakuten makes Better Life Television Co., Ltd. (currently Rakuten TV, Inc.) a wholly owned subsidiary
October 2000	Rakuten makes Infocast Co., Ltd. (currently Rakuten Travel, Inc.) a wholly owned subsidiary Rakuten Books, Inc. is founded (joint venture with Nippon Shuppan Hanbai Inc.) Rakuten USA, Inc. is founded
November 2000	Rakuten makes ProTrade Co., Ltd. (currently Target, Inc.) a wholly owned subsidiary Rakuten Investment, Inc. (currently Rakuten Enterprise, Inc.) is founded
December 2000	Rakuten makes Infoseek Japan K.K. a wholly owned subsidiary Rakuten opens Osaka Branch Office
February 2001	Rakuten makes equity investment in TECHMATRIX CORPORATION
August 2001	Rakuten makes Bizseek, Inc. a subsidiary Rakuten makes Delinavi.com Co., Ltd. (currently Rakuten Delivery, Inc.) a wholly owned subsidiary
September 2001	Rakuten makes Jgame Co., Ltd. a wholly owned subsidiary Rakuten makes Hoops Co., Ltd. a wholly owned subsidiary Rakuten makes equity investment in Signature Japan Co., Ltd.
November 2001	Show Time Co., Ltd. is founded (joint venture with Usen Broad Networks K.K.)
December 2001	Rakuten makes equity investment in Act Creation Co., Ltd. Rakuten makes equity investment in Traffic Gate, Ltd. Rakuten acquires shares of CyberAgent, Inc.
January 2002	Rakuten makes equity investment in NEXT INC.
February 2002	Rakuten makes Act Creation Co., Ltd. a subsidiary
March 2002	Main sponsorship agreement signed with Tokyo Verdy 1969
August 2002	Rakuten Travel, Inc. is founded Rakuten makes SIDE B NETWORK, INC. a wholly owned subsidiary
September 2002	Rakuten makes Bizseek, Inc. a wholly owned subsidiary Rakuten makes Ynot Inc. a subsidiary
October 2002	Infoseek Japan K.K. and Hoops Co., Ltd. merge into Rakuten Rakuten makes Signature Japan Co., Ltd. a subsidiary Rakuten makes Medioport, Inc. a subsidiary
November 2002	Rakuten makes Communication Online, Inc. a wholly owned subsidiary
December 2002	Rakuten makes Lycos Japan Inc. a subsidiary Rakuten makes Key Prime K.K. a wholly owned subsidiary
March 2003	Company system introduced
August 2003	All business operations of J Game Co., Ltd. are transferred to Infoseek Japan K.K.

Appendix 1 (cont.)

History of Rakuten (2)

Date	History
September 2003	Infoseek Japan K.K. and Lycos Japan Inc. merge into Rakuten All business operations of Rakuten Delivery, Inc. transferred to Rakuten Netprice Mall business transferred from Usen Broad Networks K.K. to Rakuten GORA business transferred from ALAN Corporation to Rakuten Rakuten makes MYTRIP NET Co., Ltd. a wholly owned subsidiary
October 2003	Rakuten makes Rakuten Books, Inc. a wholly owned subsidiary
November 2003	Rakuten makes DLJdirect SFG Securities Inc. (currently Rakuten Securities, Inc.) a subsidiary
January 2004	Rakuten signs business partnership agreement for ticketing business with LAWSON TICKET Inc.
February 2004	Rakuten makes Digipa Networks, Inc. a wholly owned subsidiary
March 2004	Main sponsorship agreement signed with Vissel Kobe
May 2004	Rakuten makes Minnano Shushoku Inc. a wholly owned subsidiary
June 2004	Rakuten makes equity investment in Ctrip.com International, Ltd.
August 2004	Rakuten Travel, Inc. and MYTRIP NET Co., Ltd. merge into Rakuten
September 2004	Rakuten makes equity investment in World Travel System Inc. Rakuten makes Aozora Card Co., Ltd. (currently Rakuten Card Co., Ltd.) a wholly owned subsidiary
October 2004	Rakuten Baseball, Inc. is founded
January 2005	Rakuten invests in Dot Commodity Inc.
January 2005	Rakuten invests in Dot Commodity Inc.
June 2005	Ynot Inc. merged into Rakuten Rakuten makes Kokunai Shinpan Co., Ltd. a subsidiary Rakuten makes Cyber Brains Co., Ltd. a subsidiary
July 2005	Rakuten makes STAR TOURS JAPAN Inc. (currently Rakuten Bus Services Inc.) a subsidiary
September 2005	Rakuten makes LinkShare Corporation a wholly owned subsidiary
December 2005	Rakuten demerges auction business and establishes Rakuten Auction, Inc.
July 2006	Rakuten establishes Rakuten ANA Travel Online Co., Ltd. in joint venture with ANA Sales Co., Ltd.
September 2006	Rakuten establishes Rakuten Securities Holdings, Inc.
November 2006	Rakuten KC Co., Ltd. transfers its credit business to Orient Corporation
August 2007	Rakuten makes Fusion Communications Corporation a subsidiary through share acquisition Rakuten Tower opens in Shinagawa-ku, Tokyo
September 2007	Rakuten establishes Rakuten & Fast Mobile Search Inc. as a joint venture with Fast Search & Transfer ASA
October 2007	Rakuten forms a capital and business partnership with OKWAVE, Inc.
December 2007	Rakuten Books, Inc. merged into Rakuten
February 2008	Rakuten establishes Taiwan Rakuten Ichiba, Inc. as a joint venture with President Chain Store Corporation Rakuten establishes Rakuten Europe in Luxembourg
March 2008	Rakuten forms a capital and business partnership with Drecom Co., Ltd.
April 2008	Providence Co., Ltd. transfers its ad network business to Rakuten

Appendix 2

7 Years of Consolidated Balance Sheets, 1999–2005

(Unit: million yen)

Assets	FY1999 (ended Dec. 31)	FY2000 (ended Dec. 31)	FY2001 (ended Dec. 31)	FY2002 (ended Dec. 31)	FY2003 (ended Dec. 31)	FY2004 (ended Dec. 31)	FY2005 (ended Dec. 31)	Liabilities and equity	FY1999 (ended Dec. 31)	FY2000 (ended Dec. 31)	FY2001 (ended Dec. 31)	FY2002 (ended Dec. 31)	FY2003 (ended Dec. 31)	FY2004 (ended Dec. 31)	FY2005 (ended Dec. 31)
Current assets								**Current liabilities**							
Cash and deposits	726	3,809	8,811	8,750	25,791	32,396	82,037	Accounts payable - trade, other		567	867	864	3,088	4,619	6,357
Notes and accounts receivable - trade	48	655	809	1,679	4,236	6,699	11,906	Accounts payable - credit guarantee							301,154
Securities	90	30,634	18,140	14,526	0	0	0	Current portion of bonds payable							12,000
Inventories		1	9	22	49	61	—	Short-term borrowings					19,500	46,897	490,029
Accounts receivable - installment							143,823	Deposits received for securities business					59,329	82,507	155,279
Accounts receivable - installment sales - credit guarantee							301,154	Margin transaction liabilities for securities business					53,459	78,701	231,758
Cash segregated as deposits for securities business	—	—	—	—	77,881	108,353	239,438	Guarantee deposits received for securities business					23,027	36,400	92,441
Margin transaction assets for securities business	—	—	—	—	58,625	87,987	285,357	Advances received, income taxes payable	384	1,205	1,622	2,392	1,911	3,897	13,532
Short-term guarantee deposits for securities business	—	—	—	—	2,180	5,769	38,648	Other	42	77	38	361	357	1,653	59,530
Operating loans						27,901	168,280	Total current liabilities	426	1,849	2,527	3,617	160,671	254,674	1,362,080
Deferred tax assets		37	132	150	2,413	1,005	7,749	**Non-current liabilities**							
Other	8	85	118	719	1,678	2,938	104,991	Long-term borrowings		—	—			2,020	186,476
Allowance for doubtful accounts	-1	-5	-20	-56	-106	-340	-28,785	Deferred tax liabilities		19	57	0	1	3,534	10,230
Total current assets	871	35,216	27,999	25,790	172,747	272,769	1,354,598	Reserve for securities transaction liabilities		—	—	—	690	1,214	2,312
								Other		8	6	7	99	30	11,276
Non-current assets								Total non-current liabilities			63	7	790	6,798	210,294
Property, plant, and equipment								Total liabilities		1,876	2,590	3,624	161,461	261,472	1,572,374
Buildings and structures	2	164	82	101	452	727	—	**Minority interests**		12	52	211	190	230	8,783
Tools, furniture, and fixtures	68	675	1,100	2,544	3,277	3,781	—	**Equity**							
Construction in progress		812	977	110	137	216	—	Share capital	446	16,383	16,390	16,407	39,761	54,059	54,135
Total property, plant, and equipment	70	1,651	2,159	2,755	3,867	4,724	20,551	Capital surplus		31,354	30,687	31,359	54,713	62,863	63,479
								Deficit		-9,396	-13,555	-16,960	-69,739	-77,311	-58,265
Intangible assets	3	438	660	1,041	1,476	3,762	65,609	Other	115	27	224	-314	1,903	6,324	17,213
Investments and other assets	43	2,950	5,569	4,469	9,926	26,301	216,950	Treasury shares		-1	-1	-272	-273	-81	-11
Total non-current assets	116	5,039	8,388	8,265	15,269	34,787	303,110	Total equity	561	38,367	33,745	30,220	26,365	45,854	76,551
Total assets	987	40,255	36,387	34,055	188,016	307,556	1,657,708	Total liabilities and equity	987	40,255	36,387	34,055	188,016	307,556	1,657,708

[Analysis memo]

Appendix 3

7 Years of Consolidated Statements of Income, 1999–2005

[Analysis memo]
(Unit: million yen)

Fiscal year (ended Dec. 31)	1999	2000	2001	2002	2003	2004	2005
Operating revenue	553	3,225	6,780	9,895	18,083	45,567	129,775
Operating expenses	325						
Cost of sales		468	1,330	2,651	1,556	4,501	14,222
Selling, general, and administrative expenses		1,710	3,845	4,692	11,776	26,006	80,668
〈Operating income〉	228	1,047	1,605	2,552	4,751	15,060	34,885
Non-operating income	1	90	141	119	48	767	2,682
Non-operating expenses	2	168	338	428	359	352	1,741
〈Ordinary profit〉	227	969	1,408	2,242	4,439	15,474	35,826
Extraordinary income (loss)		-10,079	-4,858	-5,193	-60,240	-23,912	-1,550
〈Income (loss) before income taxes and minority interests〉	227	-9,110	-3,450	-2,951	-55,801	-8,437	34,276
Income taxes - current	120	424	850	1,439	301	2,799	16,103
Income taxes – deferred		-19	-135	-1,117	-3,404	2,971	-2,541
Minority interests in income (loss)		0	-6	4	-54	61	1,266
Net income (loss)	107	-9,515	-4,158	-3,276	-52,644	-14,271	19,449

Appendix 4

Consolidated Management Indicators for the Rakuten Group

(Unit: million yen)

Fiscal year (ended Dec. 31)	1998	1999	2000	2001	2002	2003	2004	2005
Net sales	150	553	3,225	6,781	9,895	18,082	45,567	129,775
Ordinary profit	33	228	968	1,408	2,242	4,438	15,474	35,826
Net income (loss)	26	107	-9,515	-4,158	-3,277	-52,643	-14,271	19,449
Net assets	68	561	38,340	33,746	30,220	26,364	45,853	76,550
Total assets	158	561	40,255	36,387	34,055	188,016	307,556	1,657,708
Equity ratio (%)	43	57	95	93	89	14	15	5
Cash flows from operating activities			1,331	1,390	2,351	2,223	9,069	-43,358
Cash flows from investing activities			-16,763	-6,181	-3,287	-59,924	-30,040	-144,116
Cash flows from financing activities			46,626	-661	-696	63,880	27,403	235,426
Cash and cash equivalents at end of period			31,940	21,359	19,672	25,790	32,390	82,037
Number of Group employees	12	46	258	304	481	809	958	3,709

Keio Business School

KCC 2022.9 PDF