

*Business Strategy and Overcoming Lack of Market  
Institutions upon Entering Emerging Markets - Case  
Study of Heiwado's Entry into China -*

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August 2012

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# Business Strategy and Overcoming Lack of Market Institutions upon Entering Emerging Markets —Case Study of Heiwado's Entry into China—

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## **Abstract**

The purpose of this study is to examine how businesses confront lack of market institutions when entering an emerging market and building and implementing a business model to realize a corporate business strategy, in addition to how those businesses respond to the lack and establish competitive superiority. The case study used in our research was Heiwado Co., Ltd., a retailer that has established stores mainly in Shiga prefecture and that started business in China's Hunan Province in 1990.

This case study allowed us to confirm that lack of market institutions impart a significant impact on the success or failure of a company's entrance into an emerging market, and also that adroitly handling these restrictions allows a company to build and implement a business model with competitive superiority.

## **Keywords:**

business strategy, business model, institutional voids, responses

# Business Strategy and Overcoming Lack of Market Institutions upon Entering Emerging Markets

## —Case Study of Heiwado's Entry into China—

### Introduction

The purpose of this research was to examine how businesses confront lack of market institutions when entering an emerging market and building and implementing a business model to realize a corporate business strategy, in addition to how those businesses respond to the lack and establish competitive superiority. With regard to emerging markets' lack of market institutions and their requisite responses, reference was made to the concept of "institutional voids" and the related framework for strategic responses put forward by Khanna et al. (2005) and Khanna and Palepu (2010). The subject of study for our research was the conduct of retailer Heiwado Co., Ltd.—a retailer that has established stores mainly in Shiga prefecture—as Heiwado started business in China's Hunan Province in the latter half of the 1990s. Data was collected through interviews<sup>1</sup> with parties connected to Heiwado and through secondary sources as well.

What follows is a summary explanation of Hunan Heiwado Shi Ye Co., Ltd. (hereafter referred to as Hunan Heiwado) as well as Hunan Heiwado's business strategy and business model. After the summary, the theories of Khanna et al. and Khanna and Palepu will be presented, the institutional voids confronted by Heiwado in building and implementing its business model will be clarified, and the ways in which Heiwado responded to these limitations and established competitive superiority will be investigated. Finally, we will present suggestions from the information and interpretations gleaned from the case study as they apply to companies entering emerging markets, and will detail the course of further research going forward.

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<sup>1</sup> The following were the explanation about interviewees, times, and locations: Mr. Natsuhara, Heiwado President (October 2010, Heiwado Head Office, Hikone city, Shiga prefecture; and March 2011 at the Hunan Heiwado Changsha store), Mr. Sutani, Hunan Heiwado General Manager (February 2011, Kyoto; and March 2011 at the Hunan Heiwado Changsha store); Hunan Heiwado's In-Country Manager stationed in China and Hunan Heiwado's local Chinese Director of Human Resources (March 2011 at the Hunan Heiwado Changsha store); and the Officer in charge of Human Resources at the time of Hunan Heiwado's opening (October 2010, Heiwado Head Office, Hikone city, Shiga prefecture). The information that follows regarding Heiwado was all taken from these interviews, with the exception of one portion that was quoted from secondary materials.

## 1. Outline of Hunan Heiwado

Founded in 1957, Heiwado Co., Ltd. (hereafter referred to as Heiwado; Head office: Hikone city, Shiga prefecture; President: Heiwa Natsuhara) is a regional, large-scale supermarket retailer primarily in Shiga prefecture. Capitalized at approximately 11.6 billion yen and operating 145 stores in Kyoto, Osaka, Hyogo, Aichi, Fukui, and Ishikawa, in addition to their main locations in Shiga prefecture, Heiwado's consolidated financial results for the year ended February 2012 came to 389.5 billion yen in operating revenue, 11.9 billion yen in operating profit, 12.1 billion yen in ordinary profit, and 4.6 billion yen in net profit—all of which showcase the strength of this regional commercial enterprise.

Hunan Heiwado, Heiwado's China venture, operates three department stores mainly in Changsha, the provincial capital of Hunan Province in inland China. Since opening their first Chinese store in 1998, they have maintained their status as Changsha's top department store, rolling out their second store in 2007 and third store in 2009. The three stores combined for revenue of 2.1 billion yuan in fiscal 2010 (compared to 1.7 billion in the previous fiscal year), and a 20% year-on-year increase in ordinary profit. Now considering opening their fourth store, Hunan Heiwado shows a trend of growing revenues and profits and is an example of a successful retailing business in inland China.

The opportunity that led to Heiwado opening stores in Hunan Province was a fervent request from the Hunan provincial government in 1993. With sister city relations existing between Shiga prefecture and Hunan Province, the Hunan government stated its desire to have Heiwado construct large-scale commercial facilities in the provincial capital of Changsha, as "distribution infrastructure was indispensable to raising the lifestyle standards of Chinese citizens." With that request in mind, Heiwado's founder, Heijiro Natsuhara (now deceased), visited to survey the area in July 1994. Natsuhara was astounded to find that, although there were several state-run department stores in Hunan Province at the time, the employees showed no attempts to thank customers with a polite phrase or bow of the head. Being told by the provincial governor of Hunan that the land in central Changsha slated for the new department store was first class, Natsuhara firmly resolved to impart to the area the founder's philosophy of "creating a place that lets consumers experience the joy of shopping and is a store that exists for the sake of the customers." Although the Board of Directors at the time was strongly against the move, the Chairman of the Board pledged his own personal assets to make up any shortfall. This resolute conviction did not fail to persuade company President Heiwa Natsuhara, also the Chairman's son, and a joint-venture contract for a shopping center was signed in December 1994.

30 college graduates were hired as employees from the local area of the new store and brought to Japan for approximately eight months of training. For the newly hired, primarily Chinese employees, schooling was given on the Japanese style of customer service, including how to greeting customers with "Huānyíng guānglín (Welcome!)" and a smile. Furthermore, with seasonal events planned at the stores, Heiwado has been able to create a place that "lets consumers experience the joy of shopping" and is well received by the affluent classes. Initially, the department store was mostly directly managed by Hunan Heiwado. However, from 1999 to 2000, the directly managed divisions were converted to a tenant system that allowed for offering items popular with Chinese consumers. Around 2002, sales departments for clothing and cosmetics were converted to local brands sold by tenant merchants, thus creating the current management system<sup>2</sup> and providing steady growth in revenues. As a result, the store became known locally as the number one department store, and as one well-suited to its environment. This led to an increased retention ratio for employees, excellent customer service (improved quality of service and reduced fixed costs), increased applications for tenant space from famous brands, and the creation of a store that met business needs (that is, a store that thoroughly managed its tenants and stimulated competition).

## 2. Heiwado's Business Strategy and Business Model in China

What follows is a description of Hunan Heiwado's business strategy and business model.

### (1) Business strategy

We will explain Hunan Heiwado's business strategy from the perspective of several vantage points: their business opportunities in Hunan Province, their target segment, and their approach to competitive strategies such as Porter's (1980) fundamental strategies.

First, regarding business opportunities in Hunan Province, the Chairman of the Board at Heiwado had decided to open a store in Hunan Province after assessing the possibility of the option during a direct visit. This was in response to the Hunan provincial government's request for a new store. Specifically, the Chairman had directly witnessed a dearth of items at the local department stores and experienced inadequate customer service in terms of greetings and the way that purchases were handled. This was the birth of a business

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<sup>2</sup> As a result of responding to consumer tastes by arranging an assortment of products appealing to local Chinese customers, Hunan Heiwado's inventory in 2009 was 80% comprised of fashion goods such as clothing items, shoes, bags, precious metal accessories, etc., and 20% comprised of food items, food and beverage services, and daily sundries. (Yahagi, 2011, p. 330)

opportunity to make a Heiwado store that would serve as a model of "business that earns the pleasure of customers." Additionally, despite Hunan Province's approximately 68 million strong population, with approximately 5.5 million in the capital city of Changsha—the planned site of the first store—commercial infrastructure at the time was almost entirely comprised of a few state-run department stores and a myriad of open air stalls (Yahagi 2011, p. 325), which was further incentive to opening Hunan Heiwado.

The target market segment for the new venture was relatively well off, gainfully employed shoppers in their 20s and 30s. More specifically, Hunan Heiwado targeted shoppers who had graduated from college, found employment, assumed their place in the leading social class of the area, earned 3,000 yuan or more per month, and were considering marriage and purchases of computers, cars, and houses. The reason for targeting this social class was that people with these backgrounds were avid consumers and would, for example, be amenable to somewhat larger purchases when shopping for a significant other.

Below, we will dissect in more detail competitive strategies such as these, but the basic thrust of the argument is that Hunan Heiwado strove to differentiate itself from competitors by, first off, pursuing efficient management, and also by providing a wide selection of quality products, excellent customer service, and thoughtful responses to trends and customer needs. These combined to create a competitive advantage and to build a reputation as the leading department store in the region.

## (2) Business Model to Realize Business Strategy

What kind of business model did Hunan Heiwado create and implement in order to make its overseas business a success? In this chapter, we discuss theories of business models and consider the business model used by Hunan Heiwado.

Kokuryo (1999, 2004) explains the concepts of business models. Kokuryo creates "the business design principles for the four questions" in economic activity and he defines the four questions as: (a) what kind of value do you present to whom? (b) how do you offer this value? (c) with what incentives will you gather the economic resources required to offer this value? (d) what kind of profit model will you use to gain from the value your business offers? Kagono (1999) presents a similar theory with his business system. This emphasizes the relatedness between competitiveness and business organization and the important questions raised by Kagono are what kind of activity the company is responsible for, what kind of relationships will be built with external parties, and the balance between activities carried out by internal and external parties (1999, p. 44-5). Based on this, Kagono and Inoue (2004, p.

260) state that the creation of a business system is the product of a process of trial and error.

Hunan Heiwado's business model can be explained as follows, based on the above theories.

First, we apply Kokuryo's theory (1999, 2004)

(a) What kind of value do you present to whom?: Heiwado created value by aiming to become the most fashionable store with the highest sales, offering a broad variety of brands in their product lineup aimed mostly at young people in their 20s and 30s with relatively high incomes (not super-deluxe products but products in the price range that can be afforded with a bit of a splurge). Heiwado also aims to offer assurance of product quality, timely responses to customer needs, fashion advice for customers, trend creation, and to create an enjoyable store experience of customers.

(b) How do you offer this value?: Heiwado created large stores with room to stock many brands in an easily accessible and good location and offered high-quality customer service after providing comprehensive education and training to franchise staff and full-time employees, and products and advice that reflects the latest trends. Heiwado also regularly switches tenants based on indicators, including sales, responding to customer demands. Furthermore, Heiwado created an enjoyable store by carrying out fashion shows, lotteries and games, and introduced and popularized events that were previously not celebrated in the region such as Christmas, Valentines Day and New Year's Eve.

(c) With what incentives will you gather the economic resources required to offer this value?: Heiwado raised the initial capital for facilities costs from Japan. However, Heiwado brought in tenants to its stores through competition, creating the incentive of increasing their sales, by maintaining Hunan Heiwado's reputation as the most profitable and fashionable store. Heiwado also increased staff loyalty to the company and created a workplace that staff would want to work in for the long-term through social security, planning a pleasant working environment and leisure activities for staff, and a promotion system .

(d) What kind of profit model will you use to gain from the offered value?: Tenants carry out the majority of the business and Heiwado makes profit from rent based on their sales.

Next, we consider the theories of Kagono (1999) and Kagono and Inoue (2004). In aiming to be the most profitable and fashionable store, Heiwado uses a system in which it creates or ends relationships with tenants based on profit per area and contribution to overall profit. Using this, Heiwado trialed the above kind of value through differentiation and as a result this process is now incorporated into the business model.

### 3. Concerning the Market Institutions Supporting Heiwado's Chosen Business Model

In this section, we will examine the kinds of institutional voids Heiwado met with when rolling out their new store in Hunan Province and building and implementing the business model noted above. In this examination, we will base our analysis on the theories put forward by Khanna et al. (2005) and Khanna and Palepu (2010) regarding characteristic institutional voids (loop holes in the system) that businesses confront when entering an emerging market. Khanna and Palepu address three markets—capital markets, product markets, and human resource markets—in terms of institutional voids. The authors detail the following systems:

- Institutions that support credibility
- Institutions that provide advice and data analysis
- Institutions that carry out aggregation and distribution
- Institutions that allow transactions to take place
- Institutions that perform intermediation and arbitration
- Institutions that regulate (regulatory agencies, public agencies)

The authors cite inadequacies in the six functional systems above in emerging markets.<sup>3</sup>

Working from this schematic framework, below are details of the market institutions Hunan Heiwado faced in Hunan Province when opening their new store and building and implementing their business model.

First, in order to build and implement their business model, Heiwado used Japanese market institutions. The following can be cited as effective elements:

- First are the "institutions that carry out aggregation and distribution" in capital markets. For procurement of capital to fund initial costs—an amount of \$50 million that ultimately came to over \$90 million—of land purchases and facility construction, Heiwado turned not to the local capital markets, but chose Japanese markets instead, thereby avoiding one of the institutional voids in China.
- Subsequently, in regards to the "institutions that carry out aggregation and distribution" in the human capital market, Heiwado selected employees to be dispatched from their Japan operation to make up a portion of the staff who would run the new store in China, thereby providing some of the human capital that needed to be recruited locally. Also, these Japanese employees transferred the knowledge and skills they had built up in Japan to the Chinese workers hired locally, thereby fulfilling roles as trainers and advisors.

As for the restrictions that Heiwado faced in the Chinese market institutions when building and implementing its business model, the following have been confirmed:

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<sup>3</sup> Refer to Khanna and Palepu (2010) p. 57 for details.



First, in the human capital market:

- There were restrictions in the "institutions that carry out aggregation and distribution." Although the need for employees with Japanese linguistic ability was satisfied by hiring workers who had majored in Japanese at university or in high school, there was no ready supply of workers in the local Chinese labor market (given that the majority of Hunan Heiwado workers were local hires) who also had the requisite skills and experience in serving customers in the retailing industry.

Next, with regard to the product market:

- There were restrictions in "institutions that support trust." In the local Chinese retailing industry, previous new ventures had inadequately established trust in their product brands in the eyes of customers. Incidents could be cited such as frequent occurrence of counterfeit goods being sold.
- Next, the following three points have been confirmed with regard to the limitations surrounding "institutions that provide advice and data analysis." First, there was insufficient information available on products and trends showing what customers wanted to buy. Second, there were limitations in means for understanding customer needs (local tastes). Third, when Heiwado needed to design and build facilities for its new store, there was no way to contract with a Japan-based construction firm that the company had had prior experience with. Contracting with a local Chinese construction firm was the only option, but there was no source of information on the record, quality, and capabilities of local builders.
- And finally, restrictions were present in the "institutions that carry out aggregation and distribution." In this regard, if Hunan Heiwado were to directly operate the store and handle merchandise itself, it would also have to procure and source goods itself, since no wholesale dealer options were available in China. However, Heiwado was entering the region for the first time with no established trust or business relationships, and with only a small-scale purchasing network. As such, they faced difficulties in goods procurement and business negotiations with manufacturers (Yahagi 2011, p. 329). They faced the limitation of being unable to provide a wide range of products from in-house efforts alone.

This concludes the list of institutional voids we gleaned from our research on Hunan Heiwado's entrance to Hunan Province. The above restrictions and limitations were overcome through a variety of measures.

#### 4. Responses to Institutional voids and Establishment of Competitive Superiority

Below is an explanation of how Hunan Heiwado addressed the aforementioned institutional voids it experienced, starting with a review based on an overview of Khanna and Palepu's (2010) arguments for what response measures are available to companies as options.

Khanna and Palepu present the following combinations of response measures (noted in double quotations where applicable) for businesses that must address institutional voids when rolling out a new venture in an emerging market.<sup>4</sup>

- Leverage established brand power, know how, etc. to "replicate" an existing business model, or to "adapt" a business model, products, and organizations within the restrictions of the new location's market institutions.

"Compete on one's own," or tie up/merge with a local business and "collaborate."

- "Accept" the restrictions of the location's market institutions, or "attempt to change" to compensate for the limitations.
- Despite institutional voids, resolve to "enter" the market anyway, or "wait," or "exit".

Based on the framework above, the first measure that Hunan Heiwado took in response to the institutional voids was to address the lack of a source of human resources for proper customer service in the retailing industry due to the limitations on "institutions that carry out aggregation and distribution" in the local human capital market.

- The first response to this issue was to "attempt to change" by bringing new hires to Japan to train them in Heiwado's management principles, customer service practices, product sourcing, etc., in addition to on-site training in China. Once these employees had mastered these operational points, they were used on location as the pivotal trainers in customer service for the contracted tenants on each floor of the department store.
- Another attempted response was to "collaborate" with a local high school to incorporate Hunan Heiwado's concepts of service and customer care into a course of study as part of the school's curriculum. Employees were dispatched to the school to instruct the students, many of whom were later hired to work at Hunan Heiwado after graduation.

The second round of measures that Hunan Heiwado took was in response to the institutional voids in the product market. These measures are detailed below.

- Heiwado responded with "attempted to change" to address the limitations surrounding "institutions that support trust." Local stores up to that point had been lax in ensuring

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<sup>4</sup> Refer to Khanna and Palepu (2010) p. 40-44 for details.

the credibility of their brands in the eyes of customers. This response, in addition to thorough employee education, included Hunan Heiwado checking the quality of sourced products itself in order to bolster the reputability ("marketing goods under the larger Heiwado brand") of the goods it sold in its stores.

- Regarding "institutions that provide advice and data analysis," Heiwado first responded by "attempting to change" to address the dearth of product information on trends and customer tastes. This response included dispatching instructors from Japan to train full-time employees and contracted tenants in the latest trends in Japan and other countries that Chinese customers were curious about. This allowed for in-store displays reflecting advice and trends for shoppers related to fashion trends and product information. Also, since the capacities of local sales promotion companies were limited, Heiwado chose to "collaborate" with Japan-based companies in order to promote products along with information for consumers about trends in Japan, etc. Next, Heiwado chose "collaboration" as a response to the restricted means for understanding customer needs. Rather than direct management, they chose to increase the number of tenant vendors, which were managed by a local dispatch company. This response allowed for more sensitivity to the detailed tastes of local consumers, which were less evident to Japanese managers. Finally, Heiwado responded with "accept" toward the lack of information on the quality and skill of local construction companies when it came time to contract with them to build the actual facility. However, the first response of "accept" was followed later by a response of "collaborate" when Heiwado employed personnel from the Japanese human resources pool (specifically, retired individuals who were proficient in the Chinese language of the construction firms) to address demands—such as those regarding cost overrun—from the construction site manager and the construction firm. Some of these demands were considered ill-founded and Heiwado was able to have their people successfully negotiate so as to ensure that the project was brought to completion within the planned time frame.
- Concerning goods sourcing and procurement, a response of "adapt" was chosen to handle the limitations from "institutions that carry out aggregation and distribution." For merchandise, this included refining the number of products sold under Heiwado direct management; and for organization, this included reducing the proportion of directly managed departments in favor of tenant management. Also, leveraging more tenant vendors constituted, in our opinion, a response of "collaborate" to the situation.

## 5. Summary and Conclusion

Working from the case study information above, we would like to close with some final interpretations, some words on the implications for other businesses entering emerging markets, and some topics for further research going forward.

### (1) Interpretation and implications

From a case study of Heiwado's entrance into China's Hunan Province, it is clear that the company was forced to respond to a variety of institutional voids that it faced in building and implementing its business model for strategically embarking in the new market. The case study allowed us to confirm the specific human capital market and product market restrictions that existed (Figure 1).

Figure 1. Business Strategy, Business Model, and Lack of Market Institutions and Response of Hunan Heiwado

| Business Strategy   | Business Model   | Constraints on Market Institutions   | Response  |
|---|--|--|---|
| <p><b>(Opportunity)</b></p> <ul style="list-style-type: none"> <li>•Increasing demands through appropriate selection and quality of goods, improvement of concierge service</li> <li>•Large scale of population</li> <li>•Small numbers of competitors (state owned department, sidewalk vendors)</li> </ul> <p><b>(Targeted Segment)</b></p> <ul style="list-style-type: none"> <li>•University graduates with more than 3000 yuan of monthly income</li> <li>•Young generations (20s~30s)</li> </ul> <p><b>(Basic Strategy)</b></p> <p>Differentiation: selection of goods, quality, concierge service, response to customers' needs and trend</p> <p><b>(Competitive Position)</b></p> <p>Leader of the industry</p> | <ul style="list-style-type: none"> <li>•Establishment of big stores and huge selection of branded goods</li> <li>•Qualified concierge service, providing fashionable goods and advice, holding events for creating enjoyable store</li> <li>•Swift response to customers' needs</li> </ul> | <p><b>「Credibility Enhancers」</b></p> <p>(Product market) weakness in credibility of brand</p>                                     | <p>「Attempt to change」: Employee training, checking purchased goods</p>                                 |
|   |  | <p><b>「Information analyzers and advisors」</b></p> <p>(Product market) Lack of information about goods and trend for customers</p> | <p>「Attempt to change」: Employee training<br/>「Collaborate」: Using marketing company in Japan</p>       |
|   |  | <p>(Product market) Lack of information about needs of local customers</p>   | <p>「Collaborate」: Increase of tenants</p>   |
|   |  | <p>(Product market) Lack of information about abilities of construction firms</p>  | <p>「Accept」: Using a local firm<br/>「Collaborate」: Using external talent from Japan</p>                 |
|   |  | <p><b>「Aggregators and distributors」</b></p> <p>(Talent market) Supply of talents with skills for concierge service</p>            | <p>「Attempt to change」: Employee training<br/>「Collaborate」: Training students of local high school</p> |
|   |  | <p>(Product market) Lack of wholesale dealers, difficulty to product procurement</p>   | <p>「Collaborate」: Increase of tenant</p>  |

(Source) Drawn up by the authors

After investigating these institutional voids, it was clear that overcoming them as part of a

company's response to a new market is indispensable for building and implementing the business model for effectively realizing the company's strategic goals, and that the success or failure of this response bears a significant impact on the performance of the company itself. If looked at from another perspective, Hunan Heiwado's efforts to overcome the local institutional voids allowed them to build and implement a business model that other companies were incapable of, and as a result achieve a position of competitive superiority versus their rivals. These efforts with regard to limitations in the human capital market included "attempt to change" (by training personnel in-house) and "collaborate" (by working with a local high school to foster future employees), which allowed Hunan Heiwado to offer a level of high quality customer service that was previously unavailable in the local retailing industry. In the product market, their response was to address the limitations in product credibility through "attempt to change" by training employees and inspecting procured merchandise, thereby raising the level of consumer trust in their products. As for the limitations surrounding product information, again the response was "attempt to change" by training employees in product trends, etc., thereby allowing them to advise shoppers and deliver value to the shopping experience. Regarding aggregation and distribution restrictions and restrictions related to understanding customer needs, Hunan Heiwado chose a response of "adapt" for the merchandise it handled. It reduced direct management, increased the number of tenant vendors, and used this "collaborate" to both better respond to the detailed preferences of local consumers and to stock more appropriate items.

Taking the above explanation, the implication for businesses entering emerging markets is, first of all, the importance of understanding the particular problems that exist as institutional voids and their impact on the new venture as it is begun in the target market. And second, businesses must recognize that these institutional voids are not simply extra operational costs, but that successfully responding to and overcoming them can lead to establishing market superiority over one's rivals. Consequently, the way in which the business goes about its response is important and Khanna and Palepu's (2010) framework for response options is of valuable reference. However, we argue that the chosen response must vary depending on factors such as each company's experience, resources, scale, etc.

## (2) Theme for future research

This research project looked at Hunan Heiwado as a single case study. It clarified the details and the interrelationships of business strategy, the business model that supports it, the institutional voids faced when building and implementing the business model, and the

responses to those limitations, as the company ventured into the emerging market environment of China's Hunan Province.

However, as has been shown, in considering responses to institutional voids in market for businesses that differ in resources, scale, etc., it is necessary to undertake a comparison using multiple cases in order to achieve deeper insight.

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