

**Human Resource  
Development Systems  
Focusing on HR ROI**

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The importance of having a measure of human resource development with which a company can focus on the employee as an individual is increasingly receiving attention. Meanwhile, the traditional model that provides an across-the-board development program for each qualified working level has become insufficient in terms of corporate HR strategies.

The results obtained from a recent survey carried out by NRI (Nomura Research Institute, Ltd.) on listed companies also reflect this new trend. As only a few companies actually keep track of human resource development costs on an individual employee basis, a means to establish an effective standard for managing and assessing human resource development is required.

Spending on human resource development should not be considered simply as costs, but rather as investment. Taking investment efficiency into account and appropriately managing it should improve the effectiveness of human resource development. The concept of an “HR ROI” (human resource return on investment) as defined in the following equation is proposed as a standard for this purpose.

$$\text{HR ROI} = \frac{\text{Results (actual performance or expectations)}}{\text{Salary + human resource development investment}}$$

To improve the functional level of an organization over the long term, it is necessary to envision the employee career path based on the thrust of the company’s management, and to create a training and development system that combines OJT (on-the-job training) with OffJT (off-the-job training).

The ultimate benefit of setting an HR ROI comes in the ability to rationally offer training and development opportunities to high-performance employees. For a company to ensure its competitiveness over the long term, it is critical to provide attractive business opportunities to those employees with a high market value so that they will voluntarily commit themselves for the long term. To implement this, it is necessary to take a long-term perspective in approaching human resource development and to focus on target-oriented human resource management systems per se.

## I Human Resource Development Management Based on Corporate Culture

All companies are managed according to some basic objective. This objective is often referred to as the “corporate vision” or “corporate philosophy.” Strategies are devised with the aim of achieving this vision or philosophy, which constitutes a key element in characterizing a company. Personnel are also an indicator in attempting to fathom the characteristics of a company. We can ascertain the corporate culture from the quality and quantity of its human resources as well as in the company’s method of human resource development.

The seniority-based personnel system is clearly becoming an outdated system in Japan. To survive in the highly competitive environment of today and to continue to grow, companies must keep track of every employee’s performance and skills. This knowledge serves as the basis on which authority is conferred and roles are assigned to employees to execute the determined strategies.

Experience alone is no longer sufficient to ensure a significant role in today’s rapidly changing business environment. Attention is focused on performance-based personnel systems as a result of the growing awareness of the importance of human resources management.

Human resources are a factor for differentiation and a source of competitiveness. Thus, a growing number of companies are constantly expanding human resource development investment even during periods of recession. The determination of whom to target for training and development should be carefully considered, as it represents the basic policy of a company’s human resource development strategy. The first step is to consider whether to target the strategy at all employees or at specific individuals or groups of employees.

Companies that value the alignment of strategies and human resources frequently seek to intensively develop specific employees or a certain group. For example, a selected group of promising employees is singled out for the implementation of strategies, and those employees or that group is provided with extensive and wide-ranging training opportunities. Only a company capable of managing the competencies of individuals at a high level can implement strategies according to plan and in accordance with its corporate vision.

When a company attempts to focus its human resource development on specific employees or a specific group, it faces several tasks: devising its own development program, establishing precision in selecting the employees suited to the development objectives and determining the means to measure the

outcome. Another important task is to find the most appropriate way of managing the costs of developing the company strategies. Managers desire to provide intensive development opportunities to those who are selected and want them to measure up to expectations. However, those who are selected tend to be the busiest people in the company and may not be able to fulfill the company’s development ambitions.

With the above issues in mind, this paper will examine the status quo of human resource development management in the corporate world as well as the related issues inherent in the strategy implementation process. It will also examine the possibilities of human resource development management using the concept of HR ROI as a method of solving these issues.

## II Issues in Promoting Human Resource Development Management

Embodying the corporate vision and developing selected employees in carrying out corporate strategies requires an evaluation of the competence and personality of every employee as well as the establishment of the training programs and content that all employees require. When endeavoring to effectively implement such human resource development management, it is vital to create a human resource development system that incorporates the following four points.

### 1 Defining Human Resources Ideal for Implementing Strategies and the Corporate Vision

Assuming that employees share the corporate vision and strategies, there first exists the need to define the type of person who is capable of implementing these strategies and visions. The task then to be faced will be to find employees in the company who fit this definition and to determine whether these employees are capable of handling the key roles in the implementation of the strategies. It is also necessary to provide these employees with incentives, rewards and positions as well as adequate development opportunities.

### 2 Verification of Cost Effectiveness in Human Resource Development

In January 2002, NRI conducted a survey by mailing questionnaires to listed companies (replies were received from 487 of the 2,652 companies contacted, and the valid response rate was 18.4%). The survey results showed that less than 20 percent of the companies were “keeping track of development costs for individual employees (see Figure 1).” The percentage of companies that were

“already controlling development costs for individual employees as an integral part of the compensation program” was a low 1.4 percent (see Figure 2).

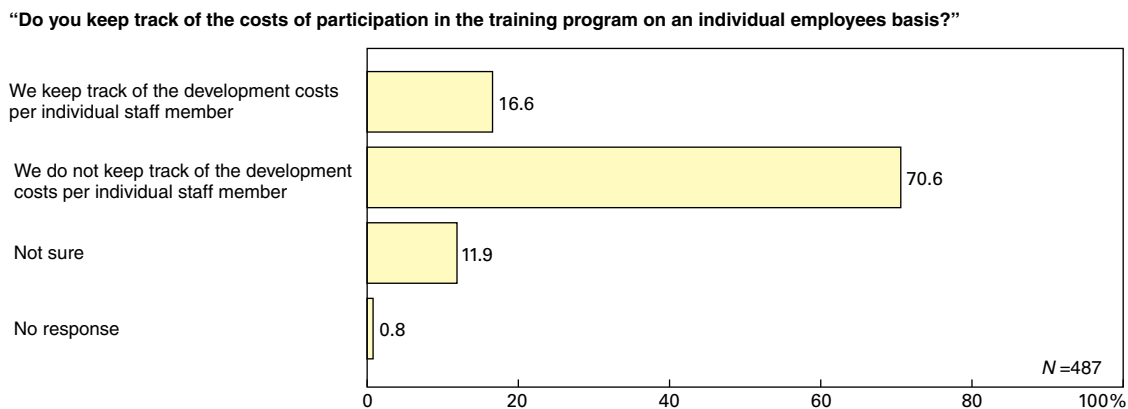
The purpose of human resource development is to increase employee contributions to the company. As a large part of such contributions manifests itself in the form of performance, Japanese companies have recently begun to adopt a performance-based evaluation system. More companies are now taking into account the outcome generated by an employee (or a team) in determining compensation.

Compensation can be regarded as the cost of encouraging employees to meet the expected outcomes in the following term, as well as the actual payment for performance. Beyond an employee’s efforts to improve these outcomes, a company also bears the costs to provide development opportunities to its employees. In this sense, the development costs can also be regarded as the cost of encouraging employees to bring the expected outcomes to fruition in the following term.

In reality, however, not many companies are keeping track of the costs for individual employees. This implies that outcomes are only measured by the compensation paid, and exclude the input (i.e., costs in employee training and development) spent on individuals. This is insignificant if the costs for human resource development are relatively small compared to compensation. However, the costs for human resource development tend to generally increase and thus disparities among employees can be expected to expand. Under these circumstances, keeping track of the costs of human resource development for individual employees is essential in human resource development.

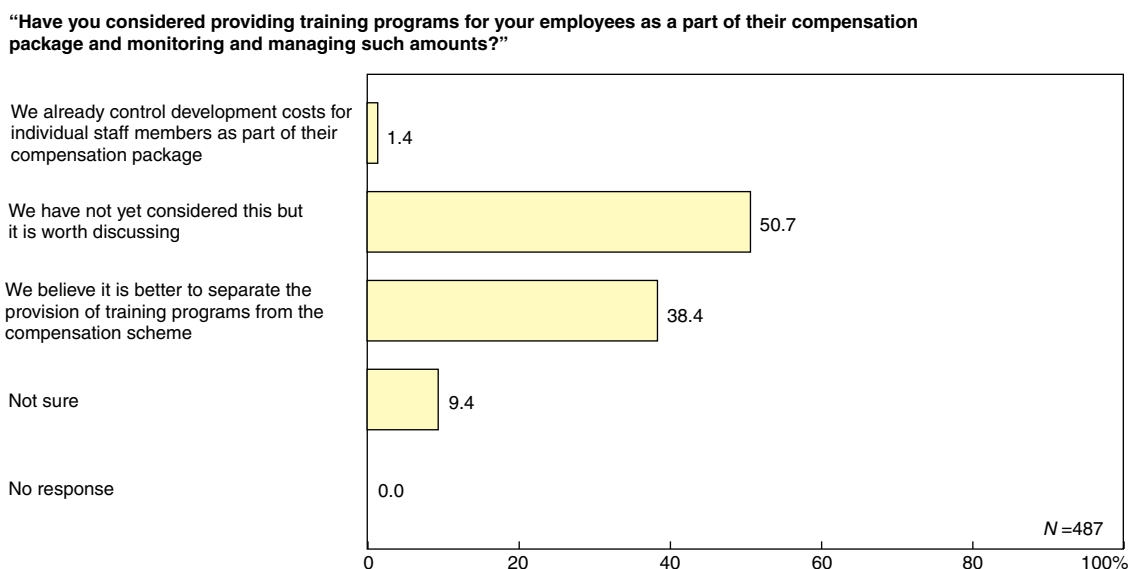
On the other hand, it is often considered impossible to accurately measure the effects of human resource development. It is certainly very difficult to define a causal relationship between an employee’s performance and development, since the effect of training often shows up only after some time has

**Figure 1. Companies Not Keeping Track of Development Costs for Individual Staff**



Source: Compiled by NRI from “Survey on Value-Based Management for Japanese Companies,” January 2002.

**Figure 2. Few Companies Control Development Costs for Individual Staff Members as a Part of the Compensation Program**



Source: Compiled by NRI, *op. cit.*

elapsed. If we see marked improvement in the performance of a businessperson, for example, it is ultimately difficult to quantitatively determine whether this was a result of a human resource development scheme or if that person just happened to ride the strength of the market.

Yet, we can classify the levels of the costs and expected effects into certain patterns by utilizing the contents of human resource development. The effects can be broken down into patterns by using such elements as the duration of the effects of development or by judging whether the increase in knowledge and skills stemming from the development scheme is applicable only in that company or in all companies. To begin with, it is more important to pay attention to the cost effectiveness of development programs by carrying out this kind of rough classification rather than through detailed quantification.

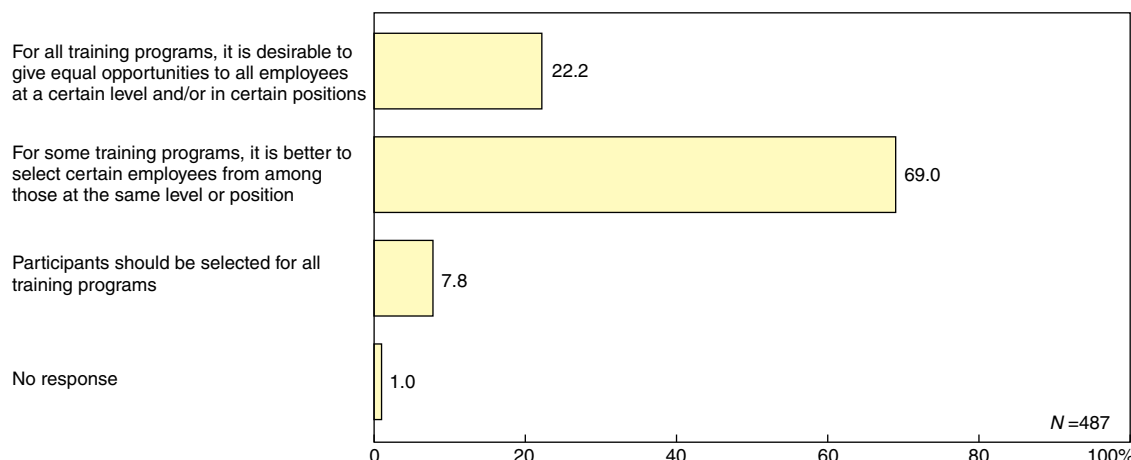
### 3 Providing Sufficient Development Opportunities to High-Performance Employees

Based on the results of the survey, many companies appear to be aware that “there will be more training opportunities for selected employees in the future” (see Figure 3), and that “future expectations” are the most appropriate selection criterion (see Figure 4). The intention to keep track of and manage the relationship between development investments in employees and their performance evaluation is natural from a management standpoint. Overall, some 30 percent of respondent companies think this approach is effective (see Figure 5).

If a company has no clear definition of the type of human resources capable of realizing its corporate vision and has taken no steps to verify the ROI of human resource development, it is essentially trying to carry out

**Figure 3. Training and Development Opportunities for Selected Employees to Increase in the Future**

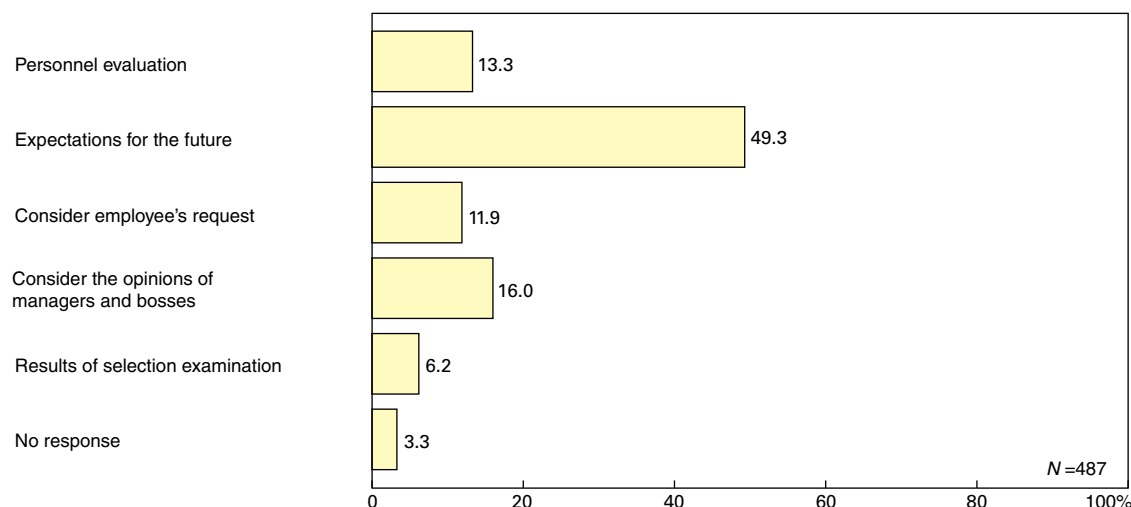
“How do you feel about providing training and development opportunities to your employees in the future?”



Source: Compiled by NRI, *op. cit.*

**Figure 4. Half of the Responding Companies Chose Expectations for the Future as the Key Selection Criterion**

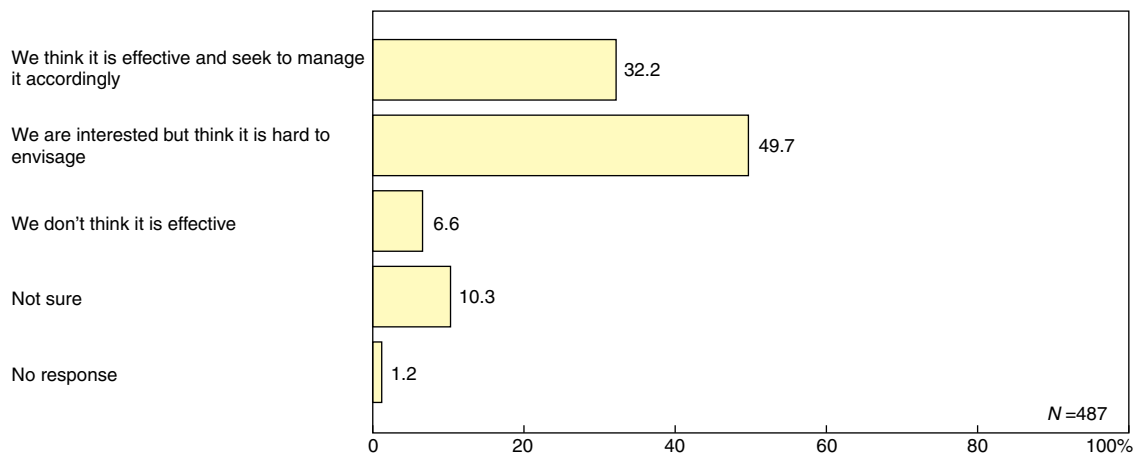
“When providing training opportunities only to selected employees, what do you think is the most suitable selection criterion?”



Source: Compiled by NRI, *op. cit.*

**Figure 5. Approximately 30 Percent of Respondents Believe Effective Management Relates to Performance Evaluation in Terms of Training Costs**

“Do you think it is effective to keep track of the relationship between the expenditures for employee development and their performance evaluations in terms of human resource development management?”



Source: Compiled by NRI, *op. cit.*

development without knowing what to expect from the process or whom to expect it from. This will result in a disparity between the performance and assessment of individual employees and given growth opportunities.

Generally, high-performance employees are likely to be the busiest people in the company and will not have time to attend training. On the other hand, employees with relatively poor performance have more time to attend training sessions. In addition, some managers may not approve of the training, as it keeps their staff away from the workplace.

However, it is often the high-performance employees who seek training opportunities to develop their knowledge and skills or to take on new challenges for their own growth. If the development of high-performance employees is neglected in order to maintain their current performance, employees will feel insecure in that they cannot envision a long-term career path. Eventually this will have a demoralizing effect.

It may also end up hampering improvements in the functioning of the organizations to which these high-performance employees are assigned. This is because high-performance employees have a positive effect on the thoughts and actions of other members in the organization. We refer to this as the “trickle down effect of knowledge.” Accordingly, it is important for the organization to provide opportunities for new challenges for high-performance employees.

#### 4 Designing Career Paths by Combining OffJT and OJT

It is said that Japanese companies have traditionally been very OJT-oriented in terms of human resource development. OJT here denotes a training system in which senior staff members demonstrate actual business process to junior employees as a means of passing

on know-how to the next generation. This tradition is based on the idea that the experience of senior staff members will be applicable to newcomers. But the business environment has changed along with the advancement of information technology and economic globalization. Depending solely on past experience is no longer an effective approach in building a winning business.

Placing a disproportionate emphasis on OJT, managers on the shop floor have tended to scorn OffJT mainly for the reason that they perceive employees who leave the workplace (even temporarily) as problematic and feel that theoretical knowledge has no immediate use in performing one’s job. However, as experience has less import today, the opportunities provided by OffJT to acquire new knowledge and skills have become more valuable.

The rational thinking processes for coping with various situations and the skills to effectively communicate with subordinates are expected to bring about effects that are sustainable over the medium and long terms. But since they are difficult to provide in the context of OJT, the importance of OffJT becomes significant.

Nevertheless, even the knowledge and skills obtained in OffJT can be filed and forgotten in a day if there is no opportunity to use them at work. Hence there is a need to provide venues or opportunities for showcasing how knowledge and skills are improved by investing in human resources. Employees equipped with enhanced knowledge and skills often leave the company simply because this kind of opportunity is not offered. They typically move overseas to study.

It is through work that newly obtained knowledge and skills can be demonstrated. However, a company should consider assigning new duties to employees as an opportunity to optimally leverage the outcomes while reforming the conventional way of doing jobs,



rather than incorporating this opportunity into traditional OJT. Advancing the careers of employees by increasing their contributions to the company—i.e., implementing the corporate vision—can essentially be seen as OJT with a long-term perspective. It is necessary for a company to prepare a career path that combines OffJT and OJT by reallocation (or transfer) as one opportunity to showcase the knowledge and skills obtained through OffJT.

### III Cases of Human Resource Development Management That Focus on Individual Staff Members

Many corporate human resource development departments are aware of the four issues listed above. Particularly, verifying cost effectiveness relating to human resource development is an ongoing task for any human resource development department. This section offers an overview of how companies with clear-cut concepts concerning human resource development are addressing these development issues.

#### 1 Selecting Content for Human Resource Development Through Consultations

The basic thinking on human resource development management at Sun Microsystems is that independent employees with diverse expertise and personalities are required to contribute to the company while improving their own employability (i.e., market value). The company thus positions itself as a venue where human resources with high market values exercise their own competencies.

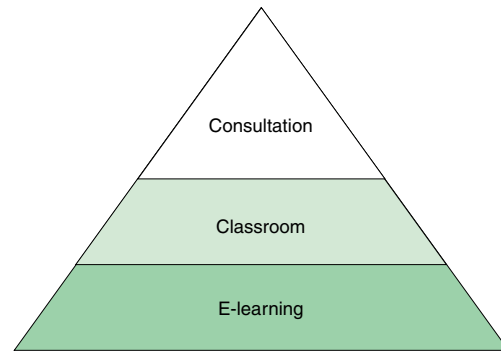
Based on this concept, the company defines human resource development as something that employees should voluntarily work on and believes that the company's role is to expand the options. Sun Microsystems broadly divides the patterns of human resource development into the three levels shown in Figure 6.

“E-learning” covers the sharing of know-how or knowledge for business, sales and management skills, not to mention the company's own products, other companies' products, and advanced technologies. Moreover, it aims at enriching both skills and contents.

“Classroom” is a program provided as part of the conventional collective training format. Because of the proliferation of e-learning, training in the classroom has been shifting to content that emphasizes the results of teamwork and to simulations of actual work scenarios. This is also a consequence of the urgent need to develop employees capable of taking key workforce roles while the company expands its vanguard formation.

“Consultation” is a format that begins with the counseling of individual employees on their career paths

**Figure 6. Human Resource Development System in Sun Microsystems**



Source: Nomura Research Institute.

and provides development menus appropriate for each employee by engaging the individual's competency—in other words, their special skills or characteristics that can lead them to high performance in a specific job (competency can also be used for personnel evaluation). In designing medium and long-term career paths for employees or selecting the relevant development content, advice on details is given through consultations based on the employee's abilities and wishes.

Verifying cost effectiveness in human resource development is also a challenge for Sun Microsystems. On a global scale, the company is now adopting a process control approach known as Sun Sigma. This campaign has been launched to deal with situations in which the employee diversity mentioned above may hamper cooperation among service sector staff.

This campaign monitors a number of different measurable factors. They include the time for inculcating the employees involved, such as the training and meeting time before commencing the campaign as well as employee comments and actions during the meetings and ultimately the results of the campaign. The cost effectiveness of this campaign is measured for each individual employee on the basis of the monitored results and used to improve cost effectiveness throughout the entire project. This campaign is not directly aimed at human resource development, but illustrates how the verification of cost effectiveness through a project can be used in order to improve personnel performance.

#### 2 Strategic Allocation of Selected and Developed Human Resources

Asahi Breweries has come up with a medium-term human resource development plan based on its five-year medium-term business plan that was launched in 2000. This medium-term human resource development plan entails three basic policies: developing business leaders, developing and creating professional human resources, and improving organizational power and reforming the organizational climate. Human resource

development is being implemented in accordance with these policies.

The company is constructively leveraging competency as a basis for this human resource development. When employees input their own competency data using a self-evaluation method, the results of the diagnoses carried out on the basis of this input will generate a schedule of training programs necessary for the respective employees. If employees input their desired long-term career pattern (known as a “career design sheet”), the competencies in need of improvement over the long term and advice on how to improve them will be provided. Data input, the selection of training programs and advice on long-term career building are available on the company’s intranet. This is designed to help all employees realize their ambitions based on their own individual skills and characteristics.

What the company considers the most important task for the basic policies is the development of business leaders. This is because business leaders are the very people who play a key role in achieving the targets of the medium-term business plan. The company has formulated what are known as “Super School I” and “Super School II” programs to train business leaders.

Super School II, which aims at educating future executives, chooses its participants from every department through a screening process. This selection process ensures transparency and uses criteria—namely, actual results and future potential—that are acceptable to everyone to avoid any erosion in the morale of staff members who are not chosen. The participants lodge together and have discussions in monthly camps held during a five-month period (individual study is required in advance). Through these discussions, they devise business plans to solve managerial problems and report the plans to their managers. Graduates from the school are strategically assigned during the annual personnel reshuffle carried out shortly after completing Super School II.

Super School I, on the other hand, is intended for top-notch frontline employees who are promising candidates for administrative positions. The school provides them with the basic framework relating to management. The candidates attend the monthly camps for the five-month period and are assigned homework before and following the camps. All employees are eligible to apply, and a quarter of the 80 applicants were selected through a two-step screening process for the first school sessions that started in 2001.

In this way, the company clearly defines the types of personnel to take charge of strategy implementation and provides policy-driven intensive development opportunities (OffJT) to high-performance employees at the workplace. Moreover, those who have successfully undertaken the program are given preferred status in reallocation in order to practice the skills they have acquired (OJT).

While the traditional working method that used to be successful for the employees of Asahi Brewery tended to be highly workplace-oriented, the company realized the importance of systematic learning when the business environment began to change dramatically. Management has thus been emphasizing the need for systematic learning among employees in creating the above development system. The graduates of Super School II appear to be achieving remarkable results in improving their willingness to learn in their respective organizations. This is a good example of how the trickle down effect of knowledge comes into play.

## IV Directions in Building Human Resource Development Systems That Focus on HR ROI

### 1 Development Costs as Investment in Human Resources

As noted above, the managing of human resource development in companies involves a number of tasks. This section focuses on the disparities between two elements—namely, the results obtained from individual employees and the provision of growth opportunities to the staff—as well as an outline of proposed measures to offset this imbalance.

Introducing a performance-based personnel system as a modus for human resource management is a current trend, and one that essentially means enhancing human resource management with respect to units or individuals. For example, the system aims at managing business outcomes of individual employees and treating them as they deserve by introducing an achievement and performance control system for individual staff members.

However, while many companies introducing a performance-based personnel system focus on detailed measurements of the results of employee performance, only a few pay any attention to the management capital invested in individual staff members or in managing the overall effectiveness of the system. In other words, they are aware of the outputs (e.g., the quantitative index of individual sales or incoming orders, and qualitative indicators such as the degree of customer satisfaction) but not of the inputs in terms of personnel evaluations.

Companies make an effort to develop their human resources in order to achieve their corporate vision. They should accordingly consider human resources not as a consumable resource, but as an asset that will increase in value through carefully managed and monitored investment. The company will then act to maximize the ROI on each of its employees. In reality, however, many companies fail to manage



the investments they expend on individual employees.

## 2 Calculating the HR ROI

We propose to utilize the concept of human resource ROI in problem solving, which sets investments in human resource development as the denominator and the return on investment as the numerator.

$$\text{HR ROI} = \frac{\text{Results (actual performance or expectations)}}{\text{Salary + human resource development investment}}$$

The concept of HR ROI is expressed with the above equation. The denominator of the HR ROI is essentially the total amount of compensation for a targeted individual employee. This total compensation includes salary, a benefits package and investment in human resource development. Since the benefits package is distributed among all employees evenly, however, we will remove this from HR-ROI calculations and use only salary and investment in human resource development as the denominator.

In preparing the calculation, it is necessary to align the human resource training and development programs to be factored in under the investment category and then to determine the proper range. Human resource development activities in reality may include the various types of OJT such as strategically shifting personnel and engaging in tasks with an educational significance. Since it is difficult to quantify these activities (to convert them into costs), these do not need to be included in the denominator.

On the other hand, results must be added to the numerator. There are two types of results: “results as a consequence” that have been realized as performance and “results as an expectation” that represent future prospects. If human resource development is considered an investment for the future, it is appropriate to include the expected results in the numerator. In other words, the company anticipates results from employees and invests according to the degree of this expectation. In fact, employees with strong potential tend to have already been successful in yielding dramatic results. Accordingly, a portion of the

results as a consequence element is indirectly reflected in the numerator.

To quantify numerator content, it is best to convert expectation results of each employee into points or to rank them just like evaluation results. For example, each level of expected results is ranked at one of five levels, A to E, and given a point rating as shown in Table 1 (the values shown in the table are just examples to illustrate the concept. In reality, these values should be set on the basis of in-depth calculations at the individual company). According to the table, when the expected result level is A, 200 points will be assigned, with 190 points and 180 points assigned for B and C, respectively.

In applying the HR ROI concept, the HR team should not calculate the HR ROI for each employee based on the expected results, compensation and outcomes of the human resource development investments.

Rather, it is better to calculate the amount of human resource development investment to be expended on each employee from the fixed values comprising expected results, compensation and HR ROI. In other words, this is a method where investment in the development of each employee is carried out in order to keep the HR ROI at a fixed rate (10% in Table 1). For instance, using this fixed HR ROI method will eliminate surpluses and shortfalls in human resource development investments.

This will be reviewed for every term (e.g., every year). Table 1 shows that, for an expected result level of A, 500 points of human resource development investment are required to maintain an HR ROI of 10 percent.

Introducing this kind of concept requires the establishment of investment level points for each human resource development program. The costs for each program can be used as these points. However, some development programs, such as a long-term study program overseas may be disproportionately expensive. In this case, it is possible to convert this cost into, for instance, a unit of years, or to set a value different from the actual costs.

How to treat the HR ROI and what value to assign to it will be the specific indicators for the company adopting an HR ROI scheme. It is pointless to compare the values of several different companies. However, if

**Table 1. Example of Points for Expected Results**

<b>Expected results (ranking)</b>	A	B	C	D	E
<b>Expected results (points)</b>	200	190	180	170	160
<b>Salary (points)</b>	1,500	1,500	1,500	1,500	1,500
<b>Human resource development investment (points)</b>	500	400	300	200	100
<b>HR ROI</b>	10%	10%	10%	10%	10%

Notes: ROI = Return On Investment  
Source: Nomura Research Institute.

the content of the human resource development programs, the points set for the programs, the compensation and distribution of the expected point outcome are disclosed, a clear picture of a company's attitudes towards human resources development can be obtained.

It is necessary to control compensation and development costs by completely separating their components in the denominator of the HR ROI equation. The fixed HR ROI rule aims at encouraging more high-performance employees to improve their skills and knowledge through a training and self-enhancement program. To reinforce this aim, it is not desirable to leave an option to turn development costs into salaries.

## V Developing HR ROI into Target-Oriented Human Resources Management

### 1 Benefits Achieved by Human Resource ROI

The HR ROI proposed in this paper begins to take on a special significance not when it is accurately converted into numbers, but when it is shared and used by the company as a criterion or benchmark that is created on the basis of certain rules. The benefits of adopting HR ROI as a criterion in a company can be summarized as follows.

Its major advantage is that it is more rational and systematic than conventional methods in providing adequate development opportunities to high-performance employees. Improving the knowledge and skills of high-performance employees will have a ripple effect throughout the entire organization. The functional level of the organization is improved through this trickle down effect of knowledge to form a virtuous circle in which the next-generation's high-performance employees are created.

Moreover, another spillover effect can also be expected. Since HR ROI aims at managing investment efficiency, a common incentive is expected to grow among the company's staff to measure or to improve the cost effectiveness of the human resource development program. In the past, the sections in charge of human resource development were not motivated enough to grasp the effects of a human resource development program objectively or quantitatively.

In the future, however, companies can be expected to define the minimum result levels expected from all targeted employees according to the type of expected effects. Thus a company is likely to be more eager to pose the cost effectiveness question.

### 2 Creating a Human Resource Management System Oriented Towards Long-Term Targets

We have had the opportunity to interview high performance employees from various companies and often feel that such people stay with their companies not simply because they are attracted to the high compensation. Beyond this, high-performance employees see their companies as a place where they can realize growth and feel the joy of developing their abilities.

The movement of human resources is becoming more fluid in Japan. Therefore, it is now important for a company to provide a venue where individual employees can realize their development and satisfy their own ambitions by staying with the company for a long period. Creating an environment that attracts personnel with a high market value and where they will remain and contribute to the company over the long term is critical for any company wishing to remain competitive.

Consequently, it is more important to link human resource development with the long-term career paths of employees than merely to increase the individual development program options. In addition, it is necessary to clearly indicate the targets and missions to be accomplished through the career path as well as the corporate and human resource visions that are the ultimate goals. In other words, human resource development can make a significant contribution to the enhancement of corporate competitiveness if it is managed and positioned within a human resource management system oriented along long-term targets.

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