

# Maximizing THE VALUE OF THE JR EAST GROUP

MUTSUTAKE OTSUKA, WHO BECAME THE NEW PRESIDENT OF JR EAST IN JUNE 2000, DISCUSSES STRATEGIES THAT WILL SHAPE THE COMPANY'S FUTURE.



**Please outline your basic management policies as the new president of JR East.**

I regard the first 13 years of JR East's history as a period when we worked to build a solid base for becoming a private-sector company. The result is that today we have completed work on the foundation needed to operate as an investor-owned company that is independent, self-reliant, and can take responsibility for its own actions. We are moving toward full private-sector ownership. An agency of the Japanese government, whose predecessor originally held all 4 million shares of our stock, now owns only 500,000 shares. All in all, we can look back on the past 13 years as a time of great accomplishments.

We are now entering a time when increasing emphasis is placed on group management and consolidated results. My job is therefore to improve our consolidated performance so as to raise the value of the entire JR East

Group. Doing this requires that we work even harder at expanding our life-style businesses. In railway operations, we will concentrate on building an even more stable management base to firmly position this sector as the nucleus of the entire group.

**What are your specific plans for achieving rapid expansion in life-style businesses?**

Due to the importance of these businesses to us in the future, life-style services are now an essential element of JR East's management. As we grow in a variety of fields, we will need to focus our resources on businesses offering maximum synergy with railway operations. We must not regard our trains merely as a stand-alone service for our customers. Instead, we need to conduct our operations so that customers want to use our non-railway services when they ride our trains, and want to ride our

trains when they use our non-railway services. This is how we should view all our businesses.

For example, when people travel on a JR East train, they can use JR East Group hotels, rental cars and shopping centers at or near stations. Consequently, offering attractive shopping facilities and hotels, and developing appealing and reasonably priced products are all ways to make more people choose to ride our trains as well. So there are many examples of ways in which we can benefit from synergies.

Our stations, which serve an enormous number of people every day, are an extremely valuable asset for us as we increase our life-style businesses. After all, stations are not just a place where you get on and off trains. I believe that we must concentrate on utilizing these assets so as to maximize their ability to produce profits. This is why we are creating more space at stations where we can set up a variety of commercial facilities such as shopping areas and counters for picking up e-commerce purchases. I strongly feel that JR East should work hard on changing stations into places that can attract more people and are easy to use. Naturally, we have many types of stations. Some are in rural areas. Others are in city centers. Some serve large numbers of commuters or students. Others tend to have a different category of passengers. JR East will be devel-

oping stations so as to take advantage of the unique characteristics of each one.

Until now, JR East has concentrated on life-style businesses that have close ties with our railway operations, since these activities are the most practical ones to take on. As a result, we have gained much expertise in hotel and shopping center operations. From now on, however, we should no longer do everything on our own. I think the time has come to make use of the knowledge at partners outside the JR East Group. Many companies regard our stations as appealing business sites. In fact, we have already formed many alliances. One brings to our stations the retailing expertise of Ryohin Keikaku Co., Ltd., whose *Mujirushi Ryohin* (no-brand merchandise) brand has widespread support, especially among young shoppers. And we have a tie-up with Fast Retailing Co., Ltd., which sells reasonably priced unisex apparel for people of all ages through *UNIQLO* stores.

In addition, we need to move quickly to formulate a business development strategy to respond to opportunities opened up by today's information-centric, networked society.

### **Exactly how will JR East be starting businesses that target information-age opportunities and make use of advances in information technology (IT) in general?**

Our railway operations already make extensive use of IT for such tasks as supervision of train movements, maintenance procedures, sales management and passenger services. In fact, I think we are one of the most advanced companies in this respect among all the world's railways.

We will now be drawing on this expertise to develop new businesses. The one that has the greatest potential is a new type of contactless IC card, which we plan to start introducing in 2001. We will begin by using IC cards as commuter passes and prepaid cards for rail transportation. We then plan to add a credit card function to make these cards even more useful. Since IC cards hold an enormous volume of data, there are many potential applications. One is electronic money. In a sense, the possibilities are infinite. But first, we want to get our IC card off to a smooth start. Then we will start applying it to new businesses.

From now on, the Internet will be a big factor as we start new businesses at our stations. Stations are an ideal



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location where the virtual and real worlds can meet, for instance, where customers can pick up merchandise ordered through the Internet. Depending on how we handle this, e-commerce-related activities could turn out to be an extremely attractive business for us. Over the Internet, we now allow people to reserve railway tickets, and we operate an electronic mall called *eki-net*. The mall is recording a growing number of hits. To make it even more popular, we will be expanding the merchandise and services available. Transaction settlements are another function that can be performed by IC cards. We have formed an IT Business Project to study the feasibility of various businesses. I am certain that we will discover a growing range of potential activities that can be conducted with our stations as their primary platform.

**What issues will you be concentrating on in the management of the JR East Group now that consolidated performance has become the primary means of evaluating companies in Japan?**

JR East's Group Strategy Formulation Committee meets about once every week. While we debate many subjects, one of the most important is establishing a clearly defined mission for each business field and business format within our group. And we need to decide on standards for evaluating how these companies fulfill their respective missions. Regarding business formats, there are two basic categories. One is companies that concentrate on increasing incoming cash. Shopping centers, hotels and restaurants are prime examples. The other category is companies formed to limit cash that leaves the JR East Group while operating as efficiently as possible. Examples here are maintenance and cleaning companies. Since we need to make our consolidated cash flows as high as possible, the chief standard of evaluating performance will probably be based on the cash flow margin (operating cash flows in relation to operating revenues). In addition, ROA will be applied to companies that use substantial amounts of assets. Overall, we will be placing greater weight on performance standards rooted in cash flows and the productive use of assets. Managers will be evaluated based on the degree to which they can meet these standards. I think that these actions will make the JR East Group more powerful and increase our aggregate value.



**“My job** IS TO IMPROVE OUR CONSOLIDATED PERFORMANCE SO AS TO RAISE THE VALUE OF THE ENTIRE JR EAST GROUP.”

At new businesses, risk management is paramount. We undertake these businesses only after carefully examining the accompanying risk. Determining exactly how much risk we are taking on is vital to conducting a broad range of businesses. Since our operating climate is undergoing rapid changes, we cannot expect all of our new businesses to go as planned. The Group Strategy Formulation Committee is responsible for deciding whether to withdraw from a business or provide additional support. For example, we liquidated a subsidiary that operated a ski resort so that this business could have a fresh start. And we shut down our automobile sales subsidiary, withdrawing from this industry. The decision to terminate a business is always an extremely difficult one for a company president. But it is vital that we have the decisiveness to prevent problems from going on year after year.

**You have stated you intend to take aggressive steps to grow in life-style businesses. What is your stance with regard to railway operations?**

Railway operations will remain the core business for the entire JR East Group. Here, our top priorities are safety and improving services for passengers. Because safe and stable transportation services is the very basis of our operations, we will make our railway system even safer and upgrade education and training programs for our employees. One more issue is how to make our services

even more price competitive.

Offering competitive prices is not just a matter of the absolute price of our tickets. Our policy is to offer a total package of services that combine reasonable prices with appealing products. Naturally, lowering expenses as much as possible is a crucial point. Over the past 13 years, JR East has made great strides in raising efficiency and streamlining railway operations. Now, we are seeing the benefits of these efforts. For example, personnel expenses are falling. In maintenance operations, efficiency is improving thanks to our relentless pursuit of advances in maintenance-related technology. Raising efficiency and developing new technology will always be central goals of ours. So we will continue to work on offering attractive travel services and packages while keeping a close eye on our expenses.

Our operating environment is often regarded as unfavorable for the railway business. Japan's population is aging as the number of children falls. But an aging population means that we will see a growing number of passengers in the upper age groups. That spells ample opportunities to increase rail travel. What we need to do is make our services easier to use for these people. Designing travel packages for their specific needs and install-

ing escalators at stations are two examples. Targeting specific customer groups has already proven successful. Last year, we began offering *Meguri Hime*, or "touring princess," ticket and travel packages aimed at housewives without small children. Sales exceeded our projections. Obviously, there is a lot of potential to increase demand for rail travel by offering packages tailored to cater to specific needs.

**Railways face competition from airlines, automobiles and other modes of transportation. In what ways is JR East dealing with this?**

We are competing and cooperating. What that means is that we are competing as best we can in sectors where we want to preserve our superiority. In other sectors, we supplement our railway network with other modes of transportation, for example, services that combine train travel with automobiles. We will continue to use both of these approaches depending on the characteristics of each market.

We work with airlines, too. Our *Narita Express* provides non-stop service between Narita Airport and central Tokyo. This provides convenience for passengers on international flights while increasing our own revenues. Our *Cassiopeia* sleeper train, which runs between Tokyo and the northern island of Hokkaido, is another example. We sell packages that allow passengers to go to Hokkaido by rail and return by air. Our Shinkansen network, which links Tokyo to five destinations, became even more competitive in December 1999. The northern terminus of our Yamagata hybrid Shinkansen, which runs on Shinkansen and conventional tracks, was extended from Yamagata to Shinjo. And that's not all. When construction on Seibi Shinkansen lines in our service area is finished, our Shinkansen network will be completed. Since that will mean more competition with airlines, we will be designing more attractive travel packages to make trains more competitive. However, we may see declines in air fares in Japan. Since passengers normally make decisions based on price, speed and service, we must ensure that we come out ahead of airlines in all three of these categories.

Our own fare adjustments have been implemented completely of our own volition. During the entire 13 years since JR East's inception, we have never raised fares



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other than to reflect Japan's consumption tax. And we plan to maintain the present level as long as we can. That will make JR East even more price competitive in relation to other transportation alternatives. While we have no plans for general fare discounts, we do plan to continue offering discounted tickets and travel packages that include discounted tickets. And our program of selling half-price Shinkansen tickets for some early morning runs for a limited period of time resulted in a net increase in passengers and revenues. This is proof that passengers are constantly on the lookout for reasonable prices. So we need to create tickets and travel packages that reflect an awareness of customers' perceptions of reasonable price levels rather than just setting a price on our own.

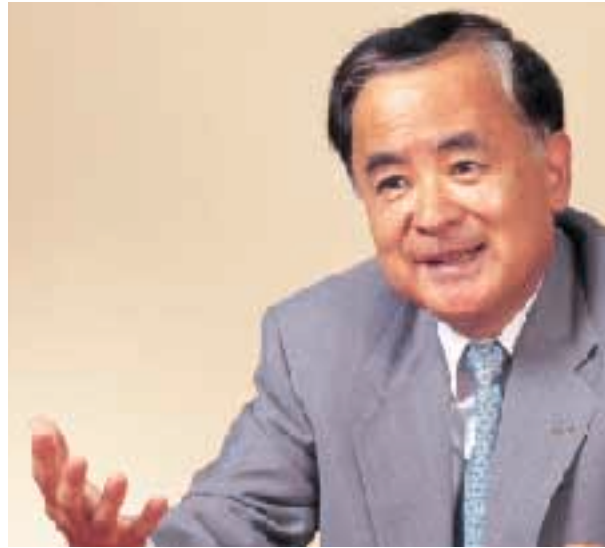
**What are your plans for achieving further reductions in the huge amount of JR East's total long-term debt?**

Reducing total long-term debt has been the number-one issue for management since JR East was formed. Over our first 13 years, we have achieved a reduction of more than ¥1.7 trillion, an enormous sum. Still, consolidated total long-term debt is about ¥4.8 trillion and nonconsolidated total long-term debt is over ¥4.6 trillion. Our fundamental policy regarding debt reduction will remain the same. We will hold capital expenditures within the bounds of depreciation to increase free cash flows and fund further debt reductions. During the fiscal year ending March 31, 2001, we plan to cut nonconsolidated total long-term debt by approximately ¥100 billion. In the following years, too, further debt reductions should be well within our means.

On a consolidated basis, we will probably need to budget a large amount of capital expenditures to start new life-style businesses. This will result in fluctuations in debt reductions from year to year. Nevertheless, the JR East Group will keep lowering the balance of total long-term debt by remaining firmly committed to its fundamental policy.

**Finally, 500,000 JR East shares are still held by a government agency. What are your plans regarding full private-sector ownership?**

We must accomplish this as soon as possible. There is no assurance that restrictions imposed by the Law for Passenger Railway Companies and Japan Freight Railway



**“Our FUNDAMENTAL POLICY REGARDING DEBT REDUCTION WILL REMAIN THE SAME. WE WILL HOLD CAPITAL EXPENDITURES WITHIN THE BOUNDS OF DEPRECIATION TO INCREASE FREE CASH FLOWS AND FUND FURTHER DEBT REDUCTIONS.”**

Company will not become an obstacle to making swift and flexible decisions.

For example, in fund procurement, taking on additional long-term loans and issuing of bonds requires the approval of the Minister of Transport. This takes time. At the moment, when interest rates are low and stable, this is not a particular problem. However, should financial markets become more volatile, swift fund procurement could be essential. Even preparing the paperwork for this approval procedure takes a great deal of time and effort. In this era of rapid change, the very existence of such restrictions is problematic.

Also, as long as the government is a shareholder of ours, there is the possibility that we could be subjected to certain pressure. The complete abolition of government ownership will mean that management of JR East will become fully our own responsibility. Achieving this self-reliance is absolutely vital if we are to fully satisfy our customers, shareholders and investors. Thus, to become a true private-sector company, we will first seek the revision of the law, and then we will ask the government agency to sell all its remaining shares in JR East.