Privatisation–Background and Future Tasks

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This article details the factors leading to the privatisation and division of JNR. It also explains the new aspects of the privatised JR companies including the listing of JR East on the Tokyo Stock Exchange. Finally, the article presents important tasks for the railways and what needs to be done to further their development in Japan.

1. Introduction

Japanese railways went through a dramatic change after the Japanese National Railways (JNR) was privatised and divided into several independent and regional companies (JR companies) in 1987. Despite the fears that many people had about privatisation, all the new companies have done well in the last 6 years (Japanese Transport Statistics in this magazine). People are talking more about "restoring the railways" nowadays and railway transportation in Japan is now highly appreciated because of its appeal and role. As modern automobile and air transport grew in the 60s, Japanese passenger railways lost market share year-after-year. But since 1990, they have maintained a market share of 35% (22% by JR companies).

In this article, I would like to introduce some recent developments in the Japanese passenger railways, especially those of JR East, the largest of the privatised JR companies.

2. History before privatisation

1. History of railways in Japan

(1) The first railway in Japan began operation in 1872. With the exception of a few railways serving large cities, all the railways were nationalised in 1906 and grew to more than 20,000 kilometers. In 1949, Japanese National Railways (JNR) was established as a national company wholly capitalized by the government. Since there was no other means of long-distance transport at that time, JNR enjoyed a virtual monopoly in land transport.

(2) This situation continued until 1955 when the road systems were improved and modernised triggering a rapid change to privately-owned cars and freight lorries. JNR lost the transport monopoly it had enjoyed for many years and suddenly found itself in financial difficulties.

(3) Ironically, JNR went into red figures in 1964 just when the world-famous Tokaido Shinkansen was completed. The company's difficulties then increased very rapidly.

2. Failure of national railways

(1) Because of this financial burden, both JNR and the Japanese government made four attempts to reconstruct the operation of the national railways by resorting to three methods:

① Rationalizing and increasing JNR productivity,
② Increasing fares, and
③ Financing by government using taxpayers' money.

However, none of these methods were successful and the red ink kept growing. Why did they fail? Because no-one was explicitly held responsible for the higher costs than the income. Because of the lack of responsibility, the state-run company sought government aid in the form of loans that kept growing. In addition, since fares were increasing year-by-year in an attempt to earn more cash and pay off debts, people were reluctant to use trains.

(2) With the spread of conditions that discouraged profit-oriented incentives, the entire company lacked cost awareness and a desire to increase productivity. Labour relations were unstable leading to lost morale. Despite the lost monopoly, JNR was slow in reforming management and improving productivity.

(3)As a public enterprise, JNR was broadly controlled by the Japanese Diet in critical aspects such as budgeting, appointments of directors, train fares, investment plans and business scope. However, because people still had overexpectations of JNR even after it lost the transport monopoly, it was forced to accept political solutions such as maintaining and even building unprofitable local lines as well as irrational electrification that could never recover the massive capital investment.

(4) For these reasons, JNR's operation soon collapsed because they were unable to respond properly to business changes, and because they tolerated irresponsible management. In 1986, the year before privatisation, JNR's deficits totalled ¥ 15.5 trillion with loans of over ¥ 25 trillion, larger than Mexico's external debts. Since it was feared that the company's huge deficits could financially jeopardize the nation, JNR reform was made the most important agenda of the Second Ad Hoc Commission on Administrative Reform started in 1981 to slim down Japan's overgrown administration.

3. Need to change management style—privatisation and division

(1) JNR failed because its system neglected efficiency (economy) and took advantage of monopoly. It failed because of the structural changes in transport caused by the rapid increase in private cars and the development of air transport. Consequently, the government could no longer rely on therapies for symptoms within the existing framework but had to seek the more radical solution of changing the framework itself.

(2) Two radical changes were needed: a change to a more efficient system (private enterprise) that would eliminate deficits, and a change to more realistic

operations (division) catering to regional transport needs. In 1982, the Second Ad Hoc Commission on Administrative Reform proposed privatisation and division of JNR. After 2 years of careful study, the Supervisory Committee for JNR Reconstruction formed in 1983 presented the government with a concrete plan for privatisation and division of JNR in July 1985.

(3) The plan called for: (1) Changing JNR to several private companies to be established according to the region and type of business; (2) Disposing of the incurred deficits to start healthier operation under the new system (of the huge JNR deficits at the end of March 1987, ¥ 14.5 trillion was to be borne by the new private JR companies with the remainder offset by selling land owned by JNR, selling stocks in the new JR companies and by taxation); and (3) Ensuring that all former JNR employees would be hired by the new JR companies or elsewhere. (The total number of employees of the new JR companies was to be 200,000 to be on par with existing private railway companies in terms of productivity—all other former JNR workers were to be hired by other companies). In April 1987, JNR was privatised and divided into several private JR companies and seven other companies based on the JNR Restructuring Law.

3. Five changes from JNR to JR

Japan's national railways had been operating for 110 years, during which time JNR had accumulated vast human resources, technologies, facilities, information and other operating resources. Unfortunately, however, JNR had grown too fat to compete with rival domestic transport companies because of its framework as a national enterprise. Privatisation of JNR allowed the management to operate more competitively under explicitly-defined responsibilities. Under the new organisation, the private JR companies inherited JNR's resources and put them to work more efficiently.

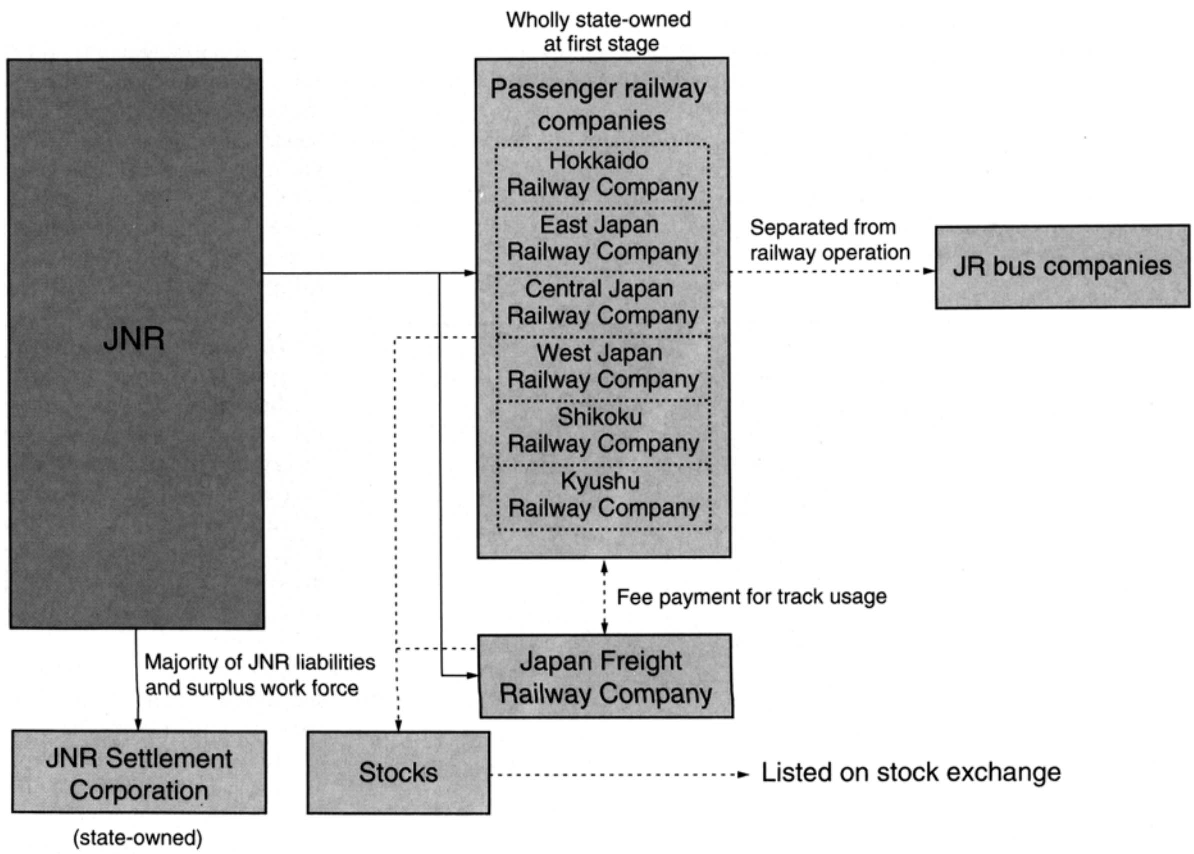
Naturally, privatisation was not meant to be a magic panacea—many privatised companies have lost power and could go bankrupt at any time. JNR privatisation was a success because all its employees understood the decision as a verdict that said "You are now on your own. Earn for yourself what you need to survive". It changed the whole direction and the entire organisation, and created a new morale among former JNR employees.

The JNR privatisation created five main changes:

1. Improved balance

The privatisation allowed the JR

Figure 1 Basic plans of JNR reform



Note 1: There is only one freight railway company, which pays railway usage fees to the JR companies owning the facilities.

Note 2: Opening liabilities are set at zero for three low-profit JR companies (Hokkaido, Shikoku and Kyushu) and a starting fund of ¥ 1.3 trillion has been set aside to help them maintain stable management.

companies to provide services and products that customers wanted, to create added-value incentives that would reduce costs, to enhance morale among employees and to activate the corporate organization. As the result, the balance of income and expenditure improved drastically.

The 6 years following privatisation turned out to be more successful than anticipated, even without a scheduled fare increase. During FY1992, the seven JR companies reported a surplus totalling ¥ 233 billion. This marked a huge change from the deficit of ¥ 2,450 billion (plus the ¥ 600 billion subsidy from the national budget) that the former JNR incurred in 1985.

As far as JR East is concerned, the privatisation is creating far better results than initially anticipated. (In 1991, the company created a profit of ¥ 108 billion against the ¥ 47.7 billion profit expected by the government.) Four years after privatisation, the company has begun paying 10% dividends. In October 1993, the seventh year of privatisation, JR East was listed on the Tokyo Stock Exchange.

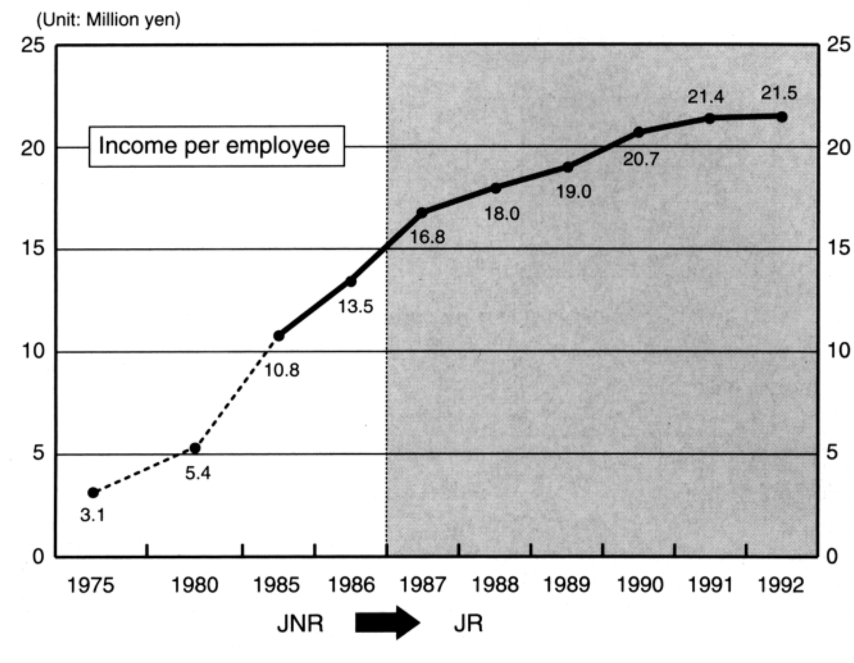
2. Improved service

The ridership has increased steadily after privatisation. (It increased by 26% among all JR companies during the past 6 years.) This increase is due to the new morale among employees which has helped them to enhance passenger services, to run departure schedules that are more convenient for passengers, to keep stations clean at all times, and to introduce modern and comfortable trains. In other words, they are going through a major change from the "We will let you ride our train." attitude of the former JNR to the "We will make you want to ride our train". Type of service.

■ Examples of improved service (JR East)

① Speed and travel time
Shinkansen 240 km/h ➔ 275 km/h
Conventional lines 120 km/h ➔ 130 km/h
② Number of express commuter trains
Sixteen departures in April 1987 ➔ 36 departures in July 1993
③ Direct connection between *Shinkansen* and conventional lines
④ Greater access to Narita (New Tokyo International Airport)
⑤ Introduction of new trains
⑥ Introduction of automatic ticket gates
⑦ "Green Information Service" (database on customer requests and suggestions)

Figure 2 Increased productivity



3. Stabilised labour relations and increased productivity

The labour relations at JNR were very poor, with bitter quarrels at the front and unfair deals at the back. After privatisation, management and labour shared a new recognition that everyone would be happy when they worked together to run a healthy and profitable company. As a result of this new recognition, the company's productivity is increasing steadily (Figure 2).

4. Engineering improvements

When the *Shinkansen* was introduced in 1964, JNR was one of the few enterprises enjoying the highest technological levels in Japan. As a result of the subsequent business decline, with most personnel involved in labour disputes rather than creative work, the former JNR fell 10 years behind others in terms of technical innovation. No-one was concerned about self-reform at that time.

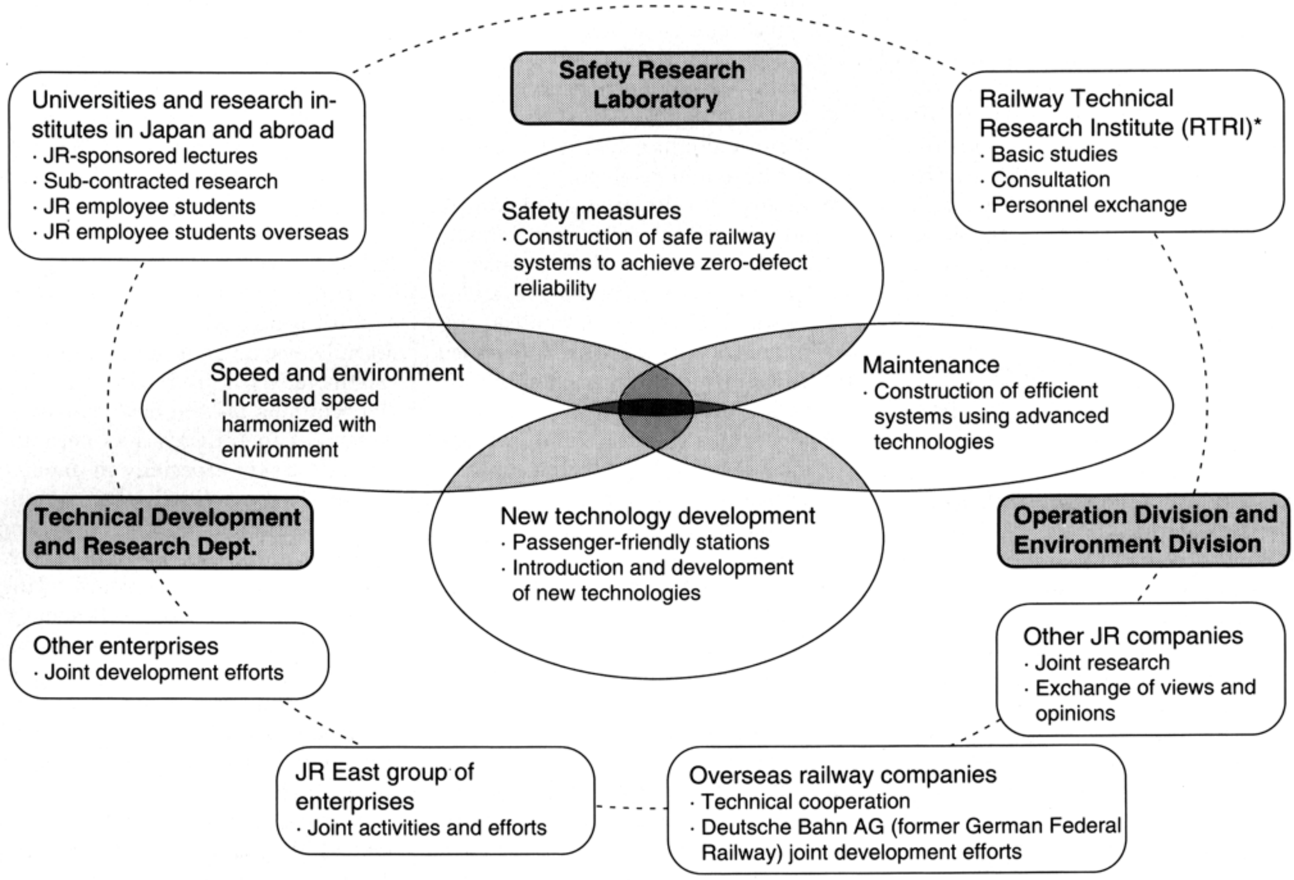
Privatisation put an end to such delays. The new JR companies are all making special efforts to increase train speeds, introduce machinery in railway maintenance and further improve the ATS system. In short, they are willing to make major investment in technical development and system development towards the 21st century (Figure 3).

5. Changes in relationship with government

The primary purpose of JNR privatisation was to end government intervention and control, and to reactivate it as a private enterprise. Before privatisation, JNR was under strict control of the Diet and government in broad aspects including budget, personnel affairs, train fares, wages, and business scope.

After privatisation, the JR companies operate on much the same basis as any other private railway company in Japan in terms of investment, wages, new businesses, etc. They are all controlled by the Railway Business Law. As a tentative measure lasting until JR stocks are sold to ordinary investors, the JR companies must submit annual business plans and lists of directors to the Minister of Transport for approval.

Figure 3 Major aspects of technical development efforts and external activities



*RTRI—Former JNR R&D function of railway technology development, a separate organization since JNR privatisation. Each of the JR companies contributes 0.35% of its fare income (0.035% for freight company) to RTRI for conducting tests and basic research of common interest.

4. Factors helping privatisation and division of JNR

1. Geographical factors

Railways require huge facilities and a large labour force resulting in an extremely high ratio of fixed costs. They are profitable only when there is high demand for transport. In Japan, most people live in cities and their suburbs. Consequently, there is a stable demand for transport within and between cities. JR East, with a total line distance of only 7,500 km, has a higher passenger-kilometer figure (130 billion passenger-km in 1992) than the former West Germany (21,000 kilometers) or France (23,000 kilometers).

2. Potential profitability of non-railway businesses

The ratio of non-railway businesses to total income among the JR companies is still low compared to conventional private railway companies. However, the ratio is increasing rapidly. There are about 180 private railway companies in Japan, and they conduct a wide variety of non-railway business to maintain profitable operation. This was one of the main factors leading to privatisation of JNR.

3. Employment capacity of government and private companies

The former JNR employed 277,000 people. If JNR had been privatised with all those employees, there would have been a surplus of labour and the new company would soon have gone out of business. The new JR companies could hire only 200,000 of the former JNR workers and the remaining 77,000 had to be hired elsewhere by cooperation between the government and private sectors. In addition, there was general public consent about such a hiring policy.

4. Understanding major reform needs after four failed reconstruction attempts

There was a growing understanding that any plan similar to the four past attempts would not help reconstruct JNR. Furthermore, politicians, scholars, the mass media and unions were unable to propose a convincing plan for reconstructing JNR other than privatisation and division into several private companies. As a result, the majority of union members supported the privatisation and division despite opposition by the largest National Railway

Workers' Union.

5. Political stability and partial support of opposition parties

Reforming JNR required eight new laws. In the 1986 general election, the ruling Liberal Democratic Party (LDP) won the majority of seats in both the House of Representatives and the House of Councillors. Reflecting public opinion, the Komeito and Japan Democratic Socialist Party parties supported the JNR privatisation and division plan.

5. Future perspectives—JR East

1. Listing on stock exchange and deregulation

JNR privatisation targeted listing on the stock exchange like other national enterprises (Nippon Telegraph and Telephone Corporation and Japan Tobacco Inc.). This is only natural in Japan's market economy with listed corporations playing a leading role. Initial plans for the JR companies include selling all their stocks to private investors (as opposed to government ownership of 33% of NTT and 50% of JT stock).

In the case of JR East, the company sold about 60% of its stock when it was listed on the stock exchange in 1993. This was meant as a first step in obtaining complete management freedom. JR East will sell its remaining stock sometime after 1994 when the other JR companies will sell their stocks.

When put into effect, government deregulation of the JR companies will revitalise them by reducing wasteful administrative costs. For this reason, deregulation towards the turn of the century of the provisions in the Railway Business Law is being discussed.

2. Major problems facing railway business

(1) Development of more reliable traffic services

- Gain more passenger trust by developing and introducing maintenance equipment incorporating advanced technologies, and by making employees more safety conscious.
- Reconstruct transport networks in and around Tokyo and reduce travel time of long-distance commuter trains to improve overall quality of commuting services.
- Install escalators in stations and make changing trains easier for the aged and disabled.
- Enlarge service areas to maximize advantages of trains and compete more efficiently with air services by consolidating transport systems in which *Shinkansen* and conventional train services are integrated efficiently including smoother access to airports.
- Modernize operation and increase efficiency by introducing maintenance by machines and maintenance-free servicing of rolling stock.

(2) Development of more active life-related services

- Join efforts with affiliated enterprises to promote life-related services so that their income rises above that of railway transport operations.
- Fully utilize station buildings, overhead rights, spaces under elevated railways and other resources to secure stable income, and aggressively promote urban development, tourism, hotel operation and other new businesses.

(3) Social contribution

- Provide quality services for local customers to contribute to development of local communities. At the same time, return to society what the company earns by taking positive roles in regional cultural activities and international cooperation.

(4) Positive development of technical innovation

- Make positive efforts in technical renovation to solve labour shortages, environmental issues and other problems. Restructure the railway and steer the company's business to a total service industry.
- For JR East itself to take the initiative in promoting R&D of new technologies.

(5) Foster the well-being of employees and their families

- Improve work environments and raise the quality of working conditions (wages, work hours, etc.) to a level appropriate for a top-grade enterprise.
- Invest in employee training programs and maximize employee abilities with greater respect for their humanity in all aspects of company management.

3. Tasks towards promoting railway modernization efforts

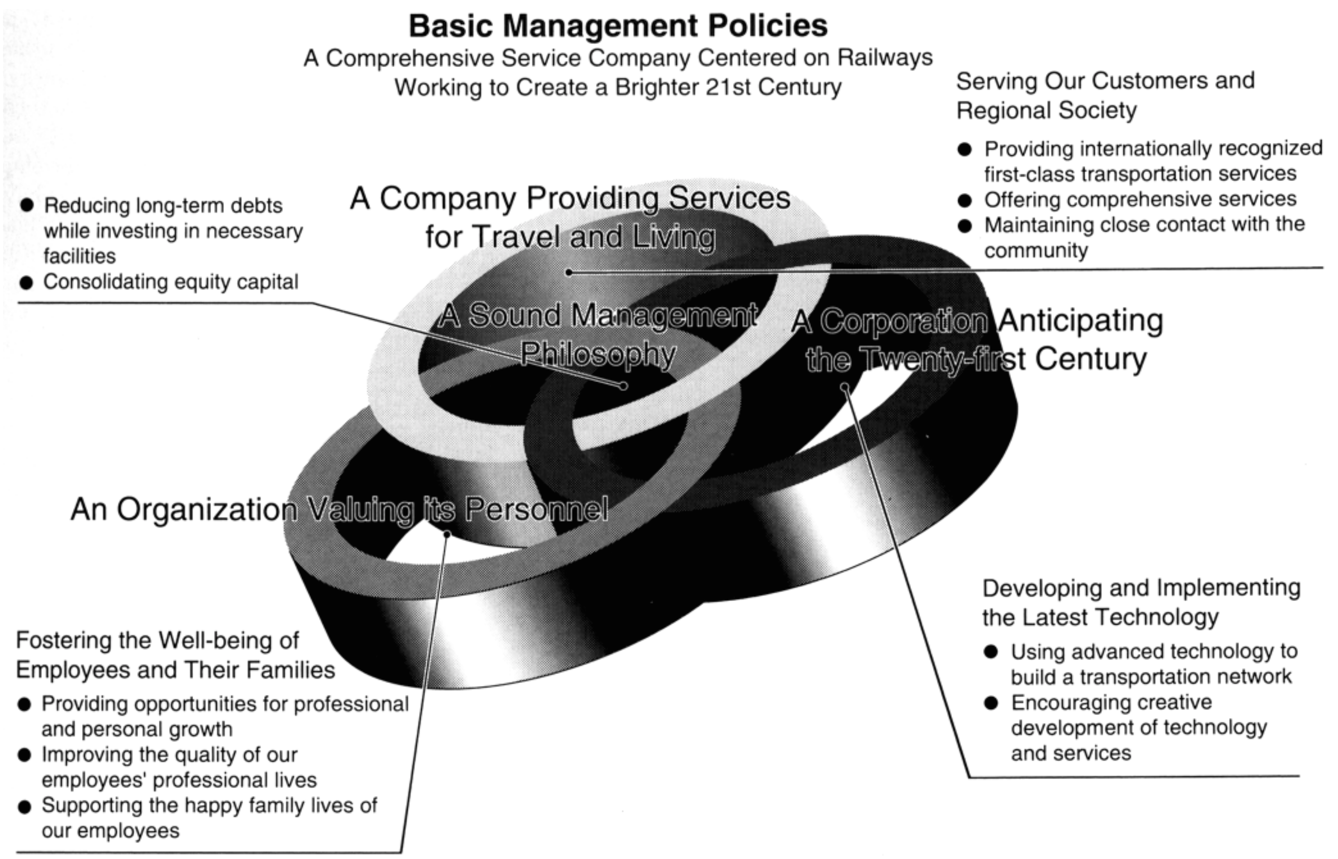
With people now seeing more future in railways, an enormous amount of investment is required to meet the public expectations for the new century. Investment in railways has become extremely risky, especially in Japan, because of the increase in the cost of land and construction work. As yet, Japan lacks an incentive mechanism for JR and other railway operators trying to improve their railways. It is about time to engage in more serious discussions at the central and local government and all other appropriate levels about financial resources, policies and taxation that will help shape an incentive mechanism.

Nevertheless, if the government controlled JR activities in any way in the name of guidance, that would again blur the division of responsibilities between the government and the JR companies. This would invite the same mistake as happened to JNR before privatisation. Under these circumstances, deregulation of laws controlling railway operators is required because this would enable role sharing between the national and local governments and railway operators and allow railway operators to respond to users' needs more promptly.

6. Conclusion

While JR East is running well today, there may be hard times ahead. To survive the difficult business environment, a long-range goal is necessary for reforming business strategies regarding the range of activities (business objectives) and products (expansion and necessary changes of market strategies) to reach that goal. Such strategies will not be achieved without first changing the organisational structure and culture by

Figure 4 Basic Management Policies



a transfer of power, and assignment of qualified personnel to appropriate posts, etc.

JR East has formulated FUTURE 21, a vision depicting an ideal image for the company at the beginning of the 2lst century, containing goals and policies to be shared by all employees. Japanese top executives have earlier expressed what they think Japanese companies must do to survive past the turn of the century. Many agreed that ① customer orientation, ② self-reform, and ③ respect for humanity, as well as correct global strategies are most important. Based on these suggestions, JR East has included the following three goals in its Basic Management Policies.

① A Company Providing Services for Travel and Living
Serving Our Customers and Regional Society

② A Corporation Anticipating the Twenty-first Century
Developing and Implementing the Latest Technology

③ An Organization Valuing Its Personnel
Fostering the Well-being of Employees and their Families

In short, the company wants to become a "total life-oriented service enterprise centred around railways that will explore the twenty-first century".

The company also realizes the necessity to return to society what the company has earned in such forms as making positive efforts to solve global environmental issues, and taking positive roles in local cultural activities and international cooperation. Since privatisation, JR East is determined to make quiet but steady efforts to become a leading railway company enjoying full customer support and trust by making major contributions to its customers, shareholders, employees and regional communities. ■

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Eiji Hosoya was born in 1945. Immediately after graduating from the Faculty of Law of the University of Tokyo, he joined Japanese National Railways in 1988. He was sent to the USA by JNR and obtained an MBA from the University of Michigan Business School. After working mainly in corporate planning and business administration at JNR Headquarters, he was assigned to the Corporate Planning Department of the newly-founded JR East. He is currently a Director of JR East and General Manager of its Management Administration Department.