

Multidirectional Management Strategy of JR Hokkaido

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Non-railway Businesses in JNR Era

Ten years have passed since Japanese National Railways (JNR) was privatized and we became JR Hokkaido, a private railway company serving Hokkaido. I recall groups of people, including myself, who were totally ignorant of anything other than railway operation, doing their best to contribute through commercial activities with no direct connection to railway operation. Before the privatization, JNR was prohibited by law from engaging in such commercial activities. Even if there had been any, there was only a slim chance of making profits in Hokkaido where there is not much economic activity in the first place. The main non-railway activities at that time were operating stores in stations and leasing facilities in People's Stations (see information box below) to outside entrepreneurs. These activities were all small scale and went no further than utilization of idle and excess facilities in station complexes. The only active engagement in commercial activities (investment in station building ownership and property leasing) was limited to terminal station buildings in

Sapporo and Asahikawa. They generated ¥3 billion (approximately 3% of earnings) during 1986, immediately before privatization. Management of the terminal station building was left in the hands of retired JNR employees who relied entirely on the station's location. The station buildings only played a role for providing a place to work for retirees. The knowhow to manage diversified businesses was never adequately accumulated.

When JNR began suffering from worsening deficits in the mid-1960s, it turned to investments in new businesses. But the layout of People's Stations was inappropriate and the company began seeking a new style of station building. When the JNR legislation was revised in 1971, it allowed JNR to invest in station buildings and to engage in a restricted manner in '...construction and management of shops and offices within the stations as well as management of dining and boarding facilities within the station complex, bus terminals, parking and other facilities located adjacent to the passenger stations'.

This allowed JNR to reflect its business intent in planning incorporation of new

companies, and design, construction and management of new station buildings. The concept of station buildings marked a turning point in changing stations from just facilities for passenger transport to more multi-functional facilities. In fact, it is the most important concept for all JR companies engaged in non-railway business today.

At first, during the JNR days, the concept was applied only to stations in large cities with high purchasing power. The new companies established to run non-railway businesses did not make any extra efforts because they already had customers. Moreover, JNR corporate culture was such that it lacked clear definition of responsibilities making it difficult to create know-how for running new businesses in any profitable manner.

JR Hokkaido was no exception; the business environment was even worse than that of the other JNR offspring in terms of market scale and market selection, because Hokkaido is generally a depopulated and cold region.

People's Stations were born out of strong demand in the postwar restoration of local cities to innovate stations to match the communities in which they were located. In doing so, the local community shared the cost of building the station with JNR and won the right to use part of the new station building for commercial purposes. A total of 66 People's Stations were built, the first being Toyohashi Station completed in 1949. Among them were Sapporo, Obihiro, Asahikawa, and Kushiro stations in Hokkaido. Their basement floors were designed for commerce and these stations presented a model for station buildings where railway companies could engage in non-railway business.



JR Hokkaido's Building next to Sapporo Station lease to a Major Department Store

(JR Hokkaido)

Need for Multidirectional Management

Poor railway characteristics

Unstable financial structure: In 1994, JR Hokkaido had a route distance of 2,623 km and 38,112, in passenger-train kilometers; 128 million passengers travelled 4,810 million passenger-km. This resulted in a railway operating revenue of ¥90.5 billion, and costs of ¥132.8 billion, producing a loss of ¥42.3 billion compensated for by interest from the Management Stability Fund (see JRTR 8, p. 5).

Running the company is tough under today's low interest rates. If the company must rely solely on railway operation, it

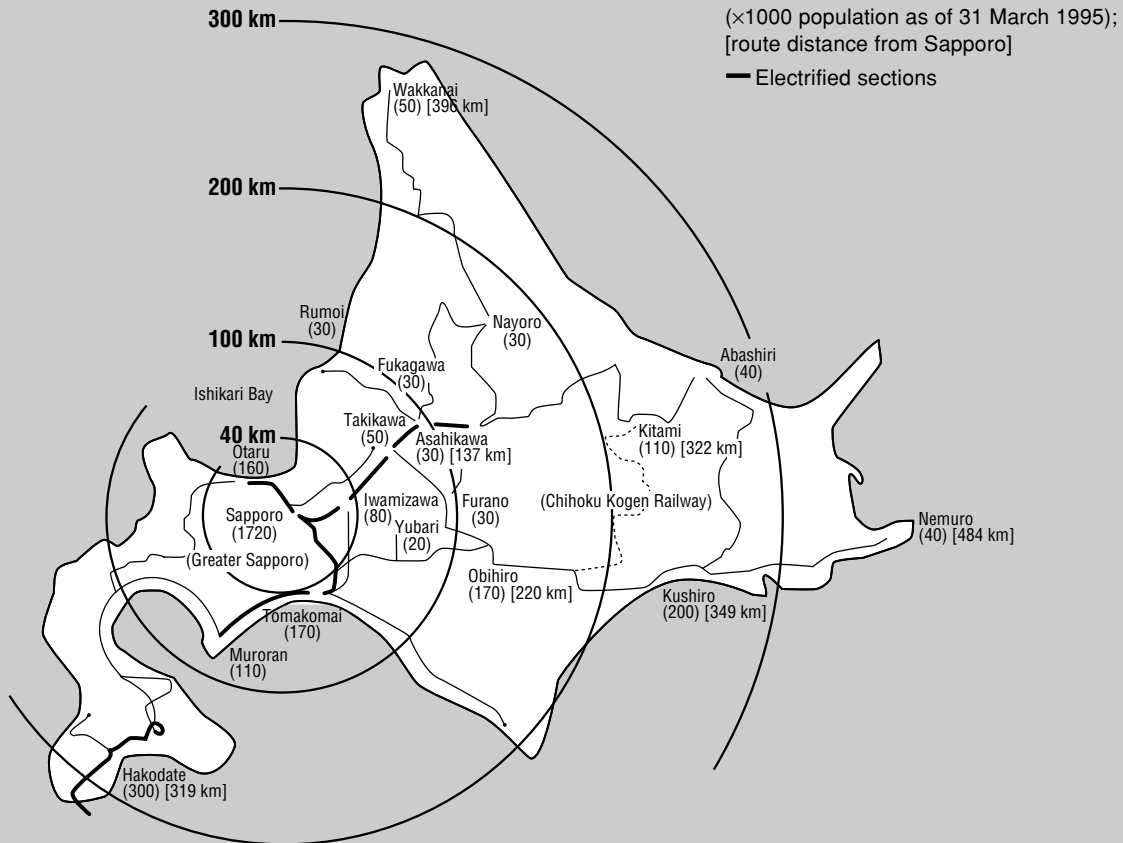
will be extremely unstable because we cannot expect a great increase in demand.

Transportation characteristics versus urban structure: It is often said that railway characteristics are maximized by (1) transportation in metropolitan areas and (2) medium-distance transportation between cities. Sapporo, with a population of 1.72 million people, is the fifth largest city in Japan after Tokyo, Yokohama, Osaka and Nagoya. The Greater Sapporo area within a radius of 40 km from central Sapporo has a population of 2.31 million, accounting for 40% of the population of Hokkaido. This shows the heavy population concentration in

Sapporo. There are 8 cities in Hokkaido with a population greater than 100,000 but there are only three cities over 200,000: Hakodate (300,000), Asahikawa (360,000) and Kushiro (200,000). Hokkaido's population density of 68 persons/km² is only 20% of the population density of 316 persons/km² in Kyushu, with which Hokkaido is often compared. The population density of Sapporo is 22 times higher than other cities in Hokkaido, whereas that of Fukuoka in Kyushu is only 11 times that of other cities in Kyushu, also suggesting the heavy population concentration in Sapporo.

As a result of this unique urban structure, JR Hokkaido enjoys good business from transportation in the Greater Sapporo

Figure 1 Major Inter-city Routes in Hokkaido



area but inter-city transportation remains extremely low. Since Hokkaido does not have shinkansen operation, it takes 3 to 5 hours to travel from Sapporo to Hakodate (319 km) and from Sapporo to Kushiro (349 km). This type of medium-distance inter-city transportation makes it hard to take advantage of railway characteristics.

Automobile-oriented society: The roads in Hokkaido cover 84,150 km, or 14.8 km per person, substantially higher than the national average of 9 km. The ratio of passenger car ownership is 0.35 cars per person, slightly higher than the national average of 0.33. The roads are never congested and driving is pleasant in Hokkaido. This makes cars the preferred means of transport all year, despite the fact that the roads are covered with snow in winter.

Undeveloped railway facilities: JNR was reluctant to make new investments in Hokkaido. In terms of the route kilometers per geographical area, JR Hokkaido rates only 30 km/km², far below the combined rate of all JR passenger companies (53 km/km²). The double track (22%) and electrification (17%) ratios in Hokkaido are far lower than the JRs' overall ratios (33% and 55%, respectively). Tracks have not been reinforced in many sections and concrete sleepers are only being introduced now for the first time in some sections serving inter-city medium-distance transportation. The undeveloped railway facilities naturally reduce the advantages of railway even further, and new investments to correct the situation present high financial burdens.

Others: On the other hand, air transportation has increased dramatically in Hokkaido during the past few years. Hakodate, Asahikawa, Obihiro and Kushiro are connected directly by air to Tokyo, Osaka and other major cities, and

even smaller cities such as Memanbetsu, Nakashibetsu and Wakkanai are connected to Tokyo. This reduces the need for feeder transport by train to and from Shin Chitose and other airports.

Positioning of non-railway businesses

The conditions suggest only slim chances for further development of railway operation, and JR Hokkaido must grow less dependent on such operation very quickly. However, looking back over the past 10 years, it seems as if everyone was busy trying to make money with no general strategy for developing non-railway businesses in any efficient manner. Starting a new business is hard in an area where railway operation is hard to expand in the first place. Nevertheless, our company is now determined to become a total service industry by developing new business. This involves changing the company's structure completely and constructing an entirely new operation. It involves rebuilding and revitalizing corporate strength by integrating railway and bus operations with new non-railway businesses. It involves adding new value to the company's management by strategic development of new railway and non-railway businesses. Developing new non-railway businesses could lead to a structural transformation as well as cultural innovation of the company.

New Business Development Method

Selecting new businesses

What shall we do and how shall we do it? Selecting the market and business method is the first problem any company faces when undertaking a new business.

Most of the new businesses that JR Hokkaido has begun stay as close to the railway business as possible while exploring new opportunities. We chose this strate-

gy because it allows us to take advantage of our existing resources to a large extent while starting something new with relatively low risk. It is also true that it may be hard, if not impossible, to expand these new businesses to a scale that can greatly improve the company's financial balance if we stick to railway operation.

JR Hokkaido's resources: Stations and the rail network are our primary resources as we explore new business. Traffic congestion and air pollution by automobiles are presenting serious environmental concerns. As a result, trains are receiving new attention as a clean and efficient means of transportation in large cities. A station is often considered the centre in an urban development project. As long as the station continues to play a central role, a large number of people will ride trains everyday. This, in turn, creates many opportunities in the station. A station is no longer a mere node along the railway; people will begin to see opportunities for many new functions and the space in a station can create new value as an amenity centre.

However, the number of passengers per station per day is small to begin with in depopulated Hokkaido. Sapporo, the busiest station in Hokkaido, serves only 176,000 passengers a day, followed by Teine Station (27,000). The eighth busiest station, Asahikawa, has only 16,000. Although Sapporo serves a far greater number than Teine, it falls far behind stations in other parts of the country, such as Shinjuku (741,000), Ikebukuro (611,000), Tokyo (421,000), and Osaka (438,000).

Areas along tracks: The areas alongside tracks were traditionally left nearly unused. However, as a result of new land utilization plans as part of urban development projects, etc., there are greater chances today to use this idle land more effectively.

JR Hokkaido owns huge tracts of railway forests and their role is gradually changing as more development projects are implemented. They, too, might find entirely new usages.

Technologies related to railways: Constructing and operating railways requires a wide range of technologies, such as mechanical, electrical, civil, and information engineering. JNR's expertise in these areas was highly evaluated by industry and academia, and it is easily applicable to areas other than railways.

Human resources: JR Hokkaido has 12,000 employees making it the largest company in Hokkaido. When JNR was privatized, the company started with 2,000 surplus employees. The surplus presents a resource when a company seeks to undertake new business.

Brand image and credibility: The public has a high image of the JRs in terms of credibility. This will play a very positive role when undertaking new business.

Methodology

Any new business requires professional know-how to actually run it. For example, a small shop in a station building requires service industry management know-how. One way to acquire such know-how relatively quickly is to join up with an enterprise that has the know-how. But a tie-up is never easy—you save time by paying for it.

There were three possible options for JR Hokkaido setting out on a new adventure:

1. Join an existing franchise as a franchisee
2. Pay for know-how in a business collaboration
3. Use equity collaboration by jointly investing in a new company with others

Business development by subsidiary

Initially, JR Hokkaido started new businesses itself without changing the company organization, but it was obviously nothing more than a copy of the state-run JNR. It lacked flexibility and the capacity to respond to changes quickly and efficiently, which led to a series of problems. We concluded that we had to establish a subsidiary to run the new businesses with sufficient flexibility and efficiency, as well as well-defined responsibilities.

This method also had problems especially in terms of human resources because it required transferring employees from the parent to the subsidiary. We had to hire inexperienced ex-JNR employees for the new subsidiary, who often presented difficulties in running a new business.

Typical Non-railway Businesses

Commercial operations in stations

Commercial use of idle space in stations is probably the easiest business. A station presents various opportunities be-

cause large numbers of people use it everyday. However, a station is also a public facility and there are restrictions as to what can be done in it. For example, profitable but offensive businesses are not acceptable. The most appropriate commercial operation would be something that adds to passenger convenience while enhancing the station's function as a railway node.

Ideally, it must blend with the commercial areas near the station. As a result of these criteria, we chose what everybody would choose—restaurants and shops selling consumer goods. We began running Mister Donut, Lotteria and other fast-food operations as well as Little Mermaid Bakeries, by becoming a franchisee. Business is good because they are all well-established franchises and everything is done as instructed in their manuals. They are run by a JR Hokkaido subsidiary and JR Hokkaido earns money by letting the space to the subsidiary. These franchises are limited to a few stations (Sapporo, Otaru, Asahikawa, etc.) with relatively large numbers of passengers.

The subsidiary is also operating kiosks



Sapporo Station after Elevation

(JR Hokkaido)

and eateries started during the JNR days. Coin lockers also produce steady profits without taking up large space.

Urban development projects

Investments in public works in Hokkaido have focused primarily on infrastructure projects in areas such as rivers, roads, ports and agriculture. More recently, investments are being made in new areas leading to enhancement of urban environments and general quality of life. The railways are receiving new attention as a clean and energy-efficient means of transportation. As a result, a number of urban development projects are being proposed centred around JR Hokkaido stations. Such projects are currently under way near Sapporo and Obihiro stations. These projects are changing the stations, aspects entirely. Similar projects are either under way or being proposed in Hakodate, Asahikawa, Kitami, Teine, Kotoni, Otaru Chikko, and other places. Urban development projects are likely to rationalize the company's scattered or otherwise inefficient railway spaces or create new spaces. This means greater ease of using JR Hokkaido land for further development. Furthermore, we enjoy reduced initial costs because the land near stations is often improved within the scope of urban development projects.

Regrading: Sapporo Station is now elevated. This has created new space underneath the tracks; before the elevation work began, we had also initiated another project to secure underground space. The space under the tracks and in the basement of the new station building provided precious room for development. It is precious because space in or near a major station is especially expensive. JR Hokkaido, through a subsidiary, built a commercial facility called Paseo 39,000 m² (total floor area, including 14,000 m² for shops) in this space.

The subsidiary is now working on addi-

tional development projects to build commercial and amusement facilities under elevated tracks at both ends of Sapporo Station.

Similar plans are also proposed for Obihiro Station where elevation work is scheduled for completion this autumn.

Readjustment: Readjustment of the land ownership near Sapporo Station will yield 15,000 m² of land for JR Hokkaido near the station. This is extremely valuable urban space in a high-use zone. A building with a total floor area of 200,000 m² can be built there because the elevated portion can be included in calculating the building volume-to-lot ratio. We are currently working on a plan to build a complex including a hotel, commercial facilities and JR Hokkaido office space. When completed, it will have the appearance and dignity appropriate for the gateway to Hokkaido. Stations in Japan are often surrounded only by commercial buildings—we must not make the same mistake. The project, tentatively scheduled to start in 2000, will be JR Hokkaido's first and last megaproject.

Meanwhile, the free space made avail-

able by the readjustment will remain empty until 2000. Over the past 3 years, we have built a temporary JR Theatre in this otherwise-idle space to show musicals. It has drawn over 760,000 people, many more than initially anticipated. This suggested the feasibility of operating a cultural facility in the station and this is now being studied as part of the complex.

A shopping mall under the station plaza is subject to readjustment. The present facility does not meet the disaster prevention standards and corrective measures must be taken. The company has plans to expand and renew the mall at the same time. When completed in 1999, it will be one of the largest underground shopping malls in Japan.

We are also building a hotel near Obihiro Station using the space made available by regrading and readjustment. The hotel with around 150 rooms will be the company's first undertaking in the hotel business since the JNR privatization. JNR operated the Asahikawa Terminal Hotel but an easy-going hotel management failed to accumulate the required know-how for the hotel business. The new



JR Theatre Temporary Built near Sapporo Station

(JR Hokkaido)



Artist's Impression of New Hotel at Obihiro Station

(JR Hokkaido)

hotel in Obihiro will be staffed by experienced personnel borrowed from an established hotel in Sapporo which will provide technical assistance. It will open in the summer of 1997 and advertising has already started.

Asahikawa Station is also the subject of a similar urban development project involving regrading and readjustment. The project will create large space under the elevated tracks, and land that can be exploited for further development.

Urban redevelopment projects: The land in front of Kotoni Station owned by JR Hokkaido is included in the city's redevelopment project. As a result, the company has acquired 10,000 m² of floor space in the new building, comprising residential, commercial, office and parking spaces, which we will lease to tenants. This provides an ideal opportunity for a company with few business and financial resources because we can turn land that can otherwise only be used for parking into highly-profitable commercial and office space with no investment. For a company with small financial resources but plenty of space along tracks, urban development projects are probably the quickest way to produce profits from idle land.

Others: As we participate in urban planning and consider ways to maximize the value of our space, we make it a rule to learn from the available development methods based on the Building Standards Law and Urban Redevelopment Law. Some of these methods are explained below.

Higher building volume-to-lot ratios: Land owners are entitled to build new buildings at higher building volume-to-lot ratios when their land is affected by cer-

tain types of urban development or readjustment, so long as they agree to create open space for public use. This system often increases the efficiency of buildings resulting in greater profitability.

Owners of facilities affected by urban development are also entitled to various low-interest-rate loans. JR Hokkaido made full use of such loans in expanding and renewing the underground shopping mall near Sapporo Station to raise profitability as much as possible, and which by its nature is unlikely to produce high profits in the first place.

Railway forests

Railway forests serving as barriers to snow or wind are common in cold areas like Hokkaido. However, the forest environments are changing rapidly due to housing development projects along the tracks and the function of railway forests is changing as a result. In this case, we must find new ways to use them more effectively. As a result, part of the railway forest near Hoshioki Station in Greater Sapporo was cut down and a JR Daiei hypermarket was built in its place. This marked our first joint venture with the



JR Daiei Hypermarket near Hoshioki Station

(JR Hokkaido)



Crawford Inn Onuma near Onuma Station

(JR Hokkaido)

Daiei chain store group and another is planned.

Another example is the small Crawford Inn Onuma hotel built on the previous site of a railway forest near Onuma Station. This hotel is designed primarily for people travelling in small groups, which seems popular nowadays. Another Crawford Inn is planned.

Railway technologies

During the JNR days, all tracks, civil engineering, station structures and buildings were designed and constructed by JNR itself. JNR had some of the best expertise in civil engineering and construction. JR Hokkaido is taking advantage of this expertise today. It has engaged in construction work exceeding ¥30 billion. One of the earliest undertakings along this line was the manufacture and marketing of prefabricated panels for homes. This began 9 years ago, shortly after the privatization. The company started this business due to the predicted future shortage of carpenters. Prefabrication of panels as home building components was revolutionary and makes this business quite unique and different from other non-railway businesses undertaken by the company.

Problems in Course of New Business Development

The business environment is very severe in Hokkaido and yet the company has no overall strategy for diversifying its activities by making full use of its business resources. We need to concentrate our efforts in terms of people, material and financial resources, on changing the business structure towards a truly strategic corporate management.

The railway operation during the JNR days was more strictly controlled than any other industry. Its organization was very much like a community where members did few things of their own will and were afraid of being different from others. Such a corporate culture creates people least suited to starting or operating a new business, so the quality of the human resources was a main obstacle. Nearly 10 years have now passed and we have gained some know-how, and new employees have been hired. It's time to review the personnel aspect of our business, develop potentials and proceed with new assignments.

The company is still dependent on old-fashioned leasing of spaces and advertising in stations and trains where we only use our land and buildings in a direct and simple manner. We must change our cor-

porate view and rebuild toward a multi-directional business operation.

Large free spaces are being created that can be explored as we like. It requires large investment but we tend to be reluctant about such investments especially in the current financial climate. However, major decisions must be made to activate the company after careful and sound forecasts for the future. Procurement of the necessary funds by sale of land or other means is essential to reduce risks.

Future Direction

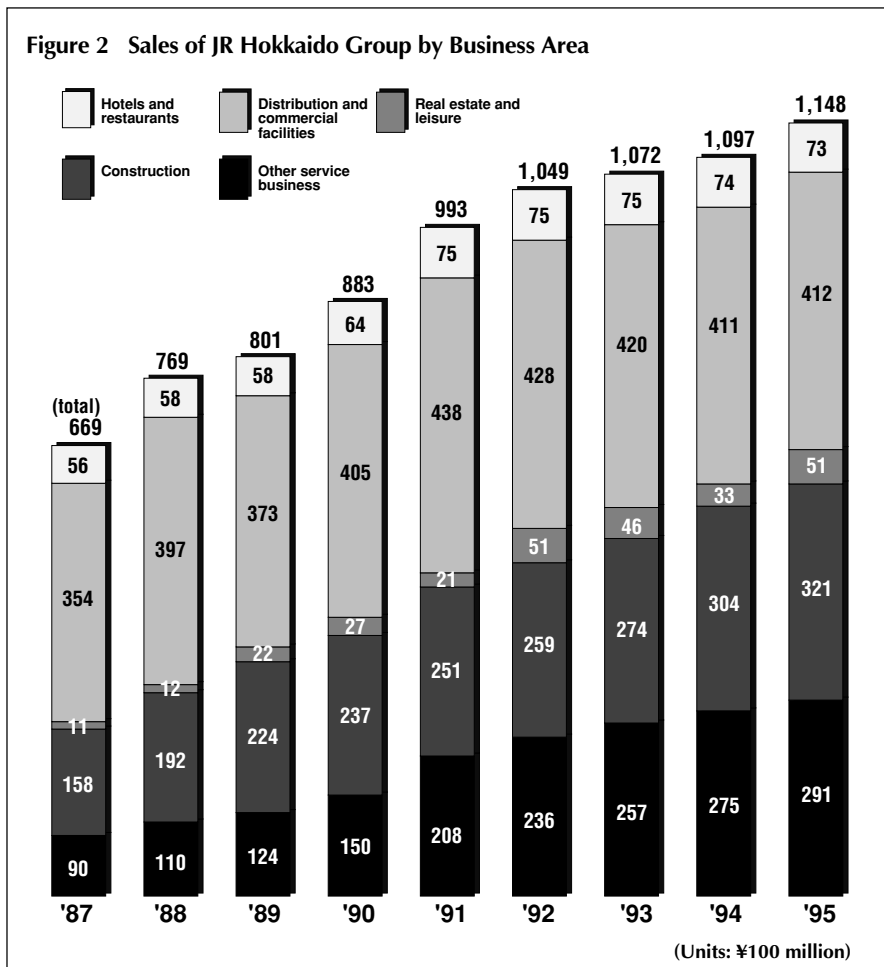
JR Hokkaido's non-railway business covers hotels, restaurants, distribution, real estate, construction and services. It has expanded to about ¥115 billion in sales, of which distribution (35%) and construction (28%) represent by far the highest percentages. We need to expand in other areas if we are to grow as a total service industry. We may make a special effort to increase the real estate business (4% at present), but we must remember that many of our current businesses are still below the break-even point, and there are some that we started but later withdrew from because they generated more losses than profits.

General economic conditions and social trends

In 1995, the birth rate in Japan marked the lowest score (1.43) ever. The Ministry of Health and Welfare predicts that 25% of Japanese in 2020 will be over 65 years of age. The falling population and increase in the number of the elderly present serious problems for Japan's future.

On the other hand, the Japanese government is shifting to a multi-axial national policy. The new policy calls for exchange between areas. When population is increasing, local communities grow in eco-

Figure 2 Sales of JR Hokkaido Group by Business Area



conomic terms because more-and-more people live in them. This is not the case when population is decreasing. For communities to prosper, we need to resort to population exchange measures.

The 20th century has been an era of reason and technology, but people still feel unsatisfied; they are beginning to look for spiritual fulfillment. How can people find spiritual fulfillment? They will find it in art, nature and culture and will travel in search of these things in the next century just as they sought reason and technology in the 20th century. We need to develop a transportation network that will make it easy for the elderly and disabled to travel.

Cultural facilities will be required for people to appreciate art. Stations could provide the place for such cultural exchange, as our JR Theatre has proved. About 15.3 million Japanese travelled

overseas in 1995 while 3.35 million foreigners visited Japan during the same year. Japan's deficit in international tourism, equivalent to 25% of the surplus in international trade, is helping correct the trade balance. But the number of foreign visitors to Japan is still very small. The Japanese Ministry of Transport has proposed *Welcome Plan 21* to double the number by the year 2005. This is accompanied by several measures to develop tourism resources.

JR Hokkaido must review the station as the basis for cultural exchange. This includes commercial as well as cultural and community facilities.

Business areas for JR Hokkaido

Our company believes that tourism is an integral part of the railway business. We must propose travel plans and make travelling a joy. We must plan events that will attract people; these events must be sufficiently unique to encourage people to actually attend. And wherever people gather together, there are new business opportunities.

Hokkaido's grand scenery cannot be appreciated fully from just trains. Rental cars make a vacation in Hokkaido even more satisfying and car rental operations may be tied in with resort facilities to ensure even greater pleasure.

This multilayered network, comprising railways, stations, cultural facilities, rent-a-cars, hotels, events, and resort facilities, will create a new type of travel promising spiritual fulfillment. It will also encourage more frequent exchange between regions. JR Hokkaido's future depends on how well we can provide these services. ■



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