



Guru Interview: Haruka Nishimatsu

The CEO of Japan Airlines talks about the Japanese airline industry, recovery strategies, and his plans for the future.

Interview by Japan Airlines

Mr Haruka Nishimatsu is the President and CEO of Japan Airlines (JAL).

He was born in 1948 in Hamamatsu Shizuoka Prefecture. He joined Japan Airlines in 1972 where he served in the corporate planning department. After a spell overseas in JAL's city and airport offices in Frankfurt, he returned to Japan to work in the finance department.

In 2003, Mr. Nishimatsu was appointed as an executive officer in charge of finance and investor relations. In 2005 he was appointed to the airline's board of directors. A year later he was promoted to the position of President and CEO of the JAL Group.

Japan Airlines was founded in the summer of 1951, and in 1953 was re-organized as a semi-government corporation with the Japanese government taking a 50 per cent share. In November 1987 the government sold its remaining stake in the company, and JAL was completely privatized.

Integration between JAL and JAS (Japan Air System) – Japan's third largest airline company – was initiated in October 2002. Integration of the two companies was completed in April 2004. The new JAL Group was born, creating an organization with a better balance between international and domestic business.

The JAL Group currently employs 38,400 staff with about 17,640 working in the airline transportation sector.

The following interview was conducted by JAL for its Annual Report 2006. To view the full report, please visit <http://www.jal.com>

What kind of business climate does the Japanese airline industry find itself in?

Haruka Nishimatsu:

The situation is different for domestic, international and cargo operations. Domestic flights have become a part of the social infrastructure, as indispensable to people's lives as electric power and railways. Thus, its business is stable, and the cost structure is very similar across the industry, but the potential for further growth is low. There are favourable factors such as an increase in the number of active seniors with the coming retirement of large number of baby-boomers, most of whom love to travel. However, the decline in the birth rate means the population is beginning to shrink.



JAL Executive Class service

On balance, therefore, we expect moderate growth for the domestic market. In international routes, on the other hand, we can expect solid and higher growth despite fierce competition. Notwithstanding a temporary decline due to 9/11, the SARS pandemic, and anti-Japan demonstrations in China, over the medium-to-long term, the market is definitely set to expand. The aviation market is especially strong in Asia, including Japan. IATA* research shows that four of the five highest-growth markets in the world are positioned in Asia.

Japan's "overseas travel rate," the aggregate number of people going overseas divided by the population, is about 13 per cent. This is lower than Europe's 20 per cent-plus, and even lower than that of Australia. In view of Japan's economic strength, this figure is quite low, which means the potential for growth that will narrow this gap is truly high. Japan's baby-boomers will start to retire from 2007. They have a lot of buying power and will have time to travel on their hands. This will lead to a higher overseas travel rate.

Also, Asian countries surrounding Japan are experiencing rapid economic expansion. With this, we also expect steady growth in the number of foreigners visiting Japan, especially as the Japanese government promotes the "Visit Japan" campaign in close cooperation with the airline and travel industry. Cargo always reflects the state of the Japanese economy. In particular, as Japanese businesses advance to China and Southeast Asia, the more overseas offices are set up, the more cargo volume is expected. I believe growth will be steady as the Japanese economy develops.

A fourth runway at Haneda Airport will be completed in 2010. This will lead to almost 40 per cent increase in arrival and departure slots, from current 295,000 to 407,000. It is planned that about 30,000 of the new slots will be allotted to short-haul international routes, serving South Korea and certain cities in China. We call this change the "internationalization of Haneda."

In addition, there is a plan to extend the 2nd Runway at Narita Airport to 2,500 metres from current 2,180 metres. This expansion of airport capacity provides us with new business opportunities. To make the most of these chances for sustainable growth, we must improve our competitiveness over the next three years and rebuild our business foundation. That is the main pillar of our medium-term business plan covering the five years from fiscal 2006 through fiscal 2010.

Looking toward a new JAL Group, we are working to regain customer trust and be thoroughly customer-oriented. At the same time, we will aggressively restructure under-performing routes and accelerate downsizing of our aircraft. In the future we will introduce 35 state-of-the-art Boeing 787 Dreamliners to our fleet with the first delivery expected in FY2008. Furthermore, the JAL Group will seriously deepen its cost structure reform to make 2009 an epoch-making year.

* IATA: International Air Transport Association

Will efforts in the Chinese market become increasingly important in the medium- to long-term?

Haruka Nishimatsu:

11 per cent of our international flight revenue comes from Chinese routes, and we expect this to grow strongly. Currently offering 276 round-trip flights a week to 12 destinations in China, we are proud of building the largest network among Japanese and Chinese airlines. We have worked to improve convenience for customers who fly back and forth between China and Japan on business trips by forming comprehensive alliances involving code-sharing and ground

handling operations with four of the six biggest Chinese airlines. These include China Eastern Airlines, based in fast-growing commercial city Shanghai, and China Southern Airlines, which is based in Guangzhou, where Japan's three major automakers have operations. Our alliances with Chinese airlines will provide further benefits as Japanese companies move deeper into central, inland areas of China where operating costs are lower. Customers can fly to the gateway cities such as Beijing, Shanghai and Guangzhou by JAL's own operation and connect to JAL's partner carriers' code-sharing flights or other connection flights inland. These flights also provide passengers with mileage accumulation and redemption just as our own flights do.



JAL's Shell Flat Seats

Although tourism declined for a while due to the SARS and other factors, China has made a national commitment to build up its tourism infrastructure such as hotels and public transportation. Moreover, taking into account the fact that China is one of the leading countries for world heritage sites, I believe the potential demand is tremendous. Japanese people are especially drawn to China's culture and history, such as traditional landscape paintings and the novel the Romance of the Three Kingdoms, and above all China is close and easy to get to. We think the shortly coming baby boomers retirement will ignite the tourism demand.

The other pillar of our China business is cargo. China has become the new "workshop of the world," and logistics between China and Japan is expanding rapidly. Not only between China and Japan, but also carrying cargo between China and Europe and the United States is also a market with great potential.

The International Civil Aviation Organization (ICAO) forecasts 6.5 per cent annual growth over the period 2002 through 2015 in cargo demand in the Asia-Pacific region. The driving force for this is, undoubtedly, China. We are covering this

attractive market with cargo freighters as well as the cargo space (bellies) of passenger aircraft. The uniqueness of China cargo market is there are many large and medium-sized cargo centres nationwide. We fly B747 cargo freighters to large centres such as Shanghai. On the other hand, we will introduce mid-sized B767 freighters to meet the demand of many medium sized cargo centres. In this way, we can realize the most effective and efficient operations, reflecting the scale of demand of each route.

"JAL used to consciously work to be No. 1 in terms of scale. Although it is important to pursue a high ranking and profits, it is wrong to make those one's only objectives. We can only win the support and understanding of the people around us by swiftly responding to social needs and fulfilling our social responsibilities."

We will improve the profitability of our international flights by downsizing aircraft.

You posted a loss in FY2005 (the year ending March 31, 2006). Please share with us the reasons and your strategy for recovery.

Haruka Nishimatsu:

The sharp rise in fuel costs had a great impact on us. In FY2005, our fuel costs were up ¥88 billion compared with the previous year. We absorbed ¥52 billion of that by raising fuel surcharges, but the remaining ¥36 billion dragged down our profits. We also experienced a series of safety-related occurrences, which affected our competitiveness, which our estimates indicate reduced our earnings by ¥12 billion for international flights and ¥20 billion for domestic flights, a total of ¥32 billion. In the previous term, we had a one-time reduction in personnel costs of about ¥50 billion due to changes in pension accounting. This one-time gain was not repeated in the reporting term. As a result, the net income/loss account deteriorated by a little over ¥77 billion compared with the previous year.

As for recovery strategies, the most important is to prevent recurrences and regain customers' trust. To cover unprecedented rises in the cost of fuel, we hedged 89 per cent of our fuel requirements for FY2006, and implemented a

wide range of fuel-saving saving measures. We were also forced to ask our customers to bear some of the burden by paying a fuel surcharge on international tickets which has gradually been reduced as the cost of fuel has decreased. Among our businesses, we will focus on improving the profitability of international flights. Since last autumn, we have quickly improved or eliminated under performing routes. In the second half of FY2005, we reduced or suspended service on seven routes – 49 flights a week, or 7 per cent of all of our international flights. We will continue to aggressively shift resources from low-profit routes to highly profitable routes, with nothing sacred.



Tokyo Narita Terminal 2 Lounge

We will also improve profitability by downsizing to medium and small sized aircraft. This will lead to improved load factor and yield and cost reductions. Today, large aircraft used internationally make up 58 per cent of our fleet. We will proactively retire large aircraft and replace them with medium and small sized aircraft, so that by 2010 the percentage of large aircraft in our fleet will have reduced to only 39 per cent. Having a higher percentage of medium and small sized aircraft and a lower percentage of large size aircraft, I believe that JAL will receive the largest benefit from downsizing the fleet among other major airlines.

We will focus on narrowing the gap between management and the front line, preventing problems and improving service.

You began your five-year medium-term business plan in FY2006. Please tell us your countermeasures for rebuilding the foundation for safe flights and regaining trust.

Haruka Nishimatsu:

I believe that the root cause of the safety-related occurrences was that management was not always completely cognizant of the situation faced by front-line staff members, which led to insufficient recognition of problem areas. By the time we reacted to them it would be too late,

which invited a series of mishaps. We have established a mechanism whereby management is aware of front-line conditions, and thus have minimized the possibility that problems will occur.

The morale of our front-line staff is also important. We can raise morale by delegating as much authority as we can, and give plenty of room for discretion. Right now, we are sorting operations into those that must be performed according to our manuals and those that can be left up to the authority of the front-line staff members.

Top management is also visiting the workplace and talking with our front-line staff members on a regular basis, in an effort to raise morale, facilitate better communications and to create a working environment with room for employee initiative.

What measures are you taking to enhance service in order to regain competitiveness?

Haruka Nishimatsu:

The flow of information between management and front-line staff has been inadequate in this area as well. Management did not fully grasp problems at airports and the needs of our customers. This led to lower competitiveness.



FY2006 was the first year of our rebirth as a company that places the highest priority on safety and a customer-oriented policy. We can obtain a great many ideas for service improvements from our front-line staff. Our employees hear directly from customers about how much our customers are satisfied with our meal service, smoothness of our check in procedure, and how comfortable our lounges are. These are all aspects of our service. From this front-line information, we can identify problem areas, and actively make improvements one after another.

Recently, passenger comments show that our in-flight meal has improved, and our JAL Shell Flat Seats, which can be laid flat, are very popular. We always see the load factor go up right after we introduce them on a route. We must continue to improve services, or we will lose business to competitors. Improving service is an endless challenge for airlines. We have to always work hard to provide service that can satisfy our customers.

On April 1 2007, JAL became a fully-fledged member of the leading quality global airline alliance, oneworld®. As member of oneworld, we will be able further to strengthen the quality of our products and services, providing our customers with greater convenience, comfort, value and choice throughout the alliance's comprehensive global network.

JAL will be reborn with a strong balance sheet through continued cost structure reform including a thorough review of procurement costs and reduction in personnel costs.

Would you touch on the strategic high points for FY2006?

Haruka Nishimatsu:

First, in international passenger operations, the key is how to deal with skyrocketing fuel prices. We use four to five times as much fuel for international flights as for domestic flights. Fluctuations in fuel prices have a large impact on profitability. We are changing over to fuel-efficient aircraft such as the Boeing 777s for flights to Europe, and diverting some jumbo jets to routes to short-haul neighbouring countries. This kind of fleet allocation leads to improving profitability.



JAL Executive Class check-in

As we did in FY2005, we are actively restructuring under performing routes in accordance with the

plan. In domestic passenger operations, the most important things are to make steady efforts to eliminate safety problems and regain profitability and competitiveness. In our cargo business, we will aggressively go after demand and we expect solid growth in Asia, especially China.



JAL Boeing 787 Dreamliner

What are the main points in revamping your cost structure, which you have been tackling since the previous fiscal year?

Haruka Nishimatsu:

We will work to reduce costs much further. First, we will review outside procurement, and substantially lower contracted unit prices. We will examine every negotiation to determine how the pricing stacks up against the average. We will investigate every item to see if we can change to less costly specifications. Our goal is to change 3,000 items. I believe this will yield lower procurement costs of about ¥10 billion. As I said, we are continuing to restructure under performing routes. On top of this, we are making the utmost effort to reduce personnel costs. We have for the first time cut down on base salaries by 10 per cent, and we aim to reduce our workforce through natural attrition.

Higher quality and better network maintenance are our most important goals: we will proactively pursue both.

As the new CEO, what are your aspirations?

Haruka Nishimatsu:

I want to promote thorough pursuit of quality and network maintenance as interdependent goals. Three things determine airline quality – safety, punctuality and service. For an airline, wider networks mean greater appeal. For example, a wider network helps customers accumulate mileage benefits. We will establish and implement specific measures in pursuit of our twin goals of raising service quality and

improving network maintenance for customer convenience.

As the new CEO, what are your commitments and thoughts on regaining trust?

Haruka Nishimatsu:

I am sure that our maintenance staff and other front-line staff have reviewed the basics of our business, and are fully dedicated to their work. We can continue to fly safely if we always go back to the basics and work with a sense of high awareness. Our management staff, including myself, will go to the front lines as often as possible to have better communication with our personnel. In Osaka, our employees carried out “OOKINI (Thank you)” campaign on a voluntary basis to express their gratitude to customers for their continued loyalty to JAL. They even made the campaign’s banner on their own. One young employee said that because people from different departments got together and cooperated to achieve the same goal, communication improved, and the work became easier.

Our front-line employees are acting with a sense of urgency and are enthusiastic in their pursuit of safe flights. Transparency in management and workplace has improved as well, and much more information about problems is now shared. We want management to continue nurturing this enthusiasm of the front-line.

We will, above all, emphasize responding to the needs of society, gaining better public understanding, and fulfilling our corporate social responsibilities.

Finally, please share with us your long-term vision and goals.

Haruka Nishimatsu:

Demand for flights in neighbouring East Asian countries is extremely strong, and our business environment has improved. Under the circumstances, JAL has a strong intention to respond to societal requirements by providing services of the highest quality and maintaining the most convenient network that customers can use without any worries at all.

JAL used to consciously work to be No. 1 in terms of scale. Although it is important to pursue a high ranking and profits, it is wrong to make those one’s only objectives. We can only win the support and understanding of the people around us by swiftly responding to social needs and fulfilling our social responsibilities. I believe that this is the most important factor in our regaining trust. We will spare no effort in doing this, and if

this also results in higher profits and a high industry ranking, so much the better. □

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