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New Hope for Trucks and Trains

Trucking capacity is down, railroads are eliminating bottlenecks, and carriers' meager profits could soar when the economy picks up.

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By Philip Siekman

Back when the economy was perking along, the term "supply chain" was usually accompanied by a reference to some computer program touted as the way to "automate all aspects of global logistics." Far less attention was paid to what's been happening among the truckers and railroaders that actually move cargo rather than mere data. Out in this real world, while dot-coms disappear, freight carriers have been doing more with less while getting better at meeting customer needs.

U.S. Xpress Enterprises, one of the biggest truckers, not only uses satellites to make sure its trucks arrive on time but also is working on a system that will let it know when the doors of parked trailers have been opened. Customers of BNSF, the Burlington Northern Santa Fe railroad, can access its Website to order different types of railcars for upcoming shipments about as easily as picking two from column A and three from column B in a Chinese restaurant.

Both the railroads and the truckers have joint programs that use computer wizardry. Railinc, owned by the railroads' trade association and located in Cary, N.C., can tell you the location of almost any of the 700,000 freight cars moving about North America every day. Transplace in Plano, Texas, which was created by a group of large trucking companies, can wrestle the algorithms of operations research through its computers to revamp your supply chain.

Unfortunately, dazzling technology has not produced dazzling profits. Last year, according to DRI-WEFA, an economic forecasting group in Lexington, Mass., 13.4 billion tons of cargo was moved in the U.S., 67% of it on trucks and 14% on trains. That generated a national freight bill of roughly \$600 billion. But the big truckers and the railroaders weren't able to hang on to much of it. Says Brian Clancy, a principal at Merge Global, an Arlington, Va., consulting firm: "For guys trying to make a living moving freight, the fundamental challenge is, When are they going to earn their cost of capital?"

In the '90s, movers of freight squeaked by. Shipments were rising, fuel costs were low, and insurance companies were buying market share as long as their investment portfolios were doing well. In the last year or so, however, things turned from not so good to really lousy. Shipments sagged. Insurance premiums and fuel prices rose. Following the Sept. 11 terrorist attacks, new security measures added to costs.

Donald Broughton, an equity analyst with A.G. Edwards in St. Louis, calculates that in the past two years, as a result of bankruptcies and the repossession of trucks now languishing in used-vehicle lots, as much as 13% of U.S. interstate truckload capacity has been taken off the road. Even the big

railroads, superconcentrated into what they insist is not an oligopoly, don't make a decent profit. As a group, the remaining four big U.S. lines--BNSF, Union Pacific, CSX, and Norfolk Southern--earned less than 3% on total assets last year.

Nevertheless, there may be light somewhere up ahead in this dark tunnel. No transport company is going to wow Wall Street until the U.S. economy recovers. But the freight carriers could come out of this malaise leaner and with a shot at getting a decent profit. One trucker that thinks it's possible is U.S. Xpress, at which we take a closer look in the following pages. After that we report on what's going on at two railroads, BNSF and Norfolk Southern, whose CEO says he has a strategy for providing a fair return to stockholders.

A trucker trims costs

Making a transcontinental run with a trailerload of parts and arriving right on time at the assembly plant may sound like the latest supply-chain feat, but it's old news for long-haul truckers. U.S. Xpress Enterprises, fifth in size among the publicly held truckload carriers and second to none in the deployment of sophisticated technology, got its start in Chattanooga 15 years ago doing just that sort of run. Back then Max Fuller, now 48, and Pat Quinn, now 54, were working at Southwest Motor Freight, a company owned by Fuller's father. While most truckers were trying to figure out how to deal with deregulation, they spotted something else. Recalls Fuller: "People were starting to talk about a new concept, 'just-in-time delivery.' We said, 'Well, if that's going to happen, there's a real gap in the trucking capability of this country.'"

Fuller and Quinn, still co-chairmen of the company, calculated that if one driver slept in the back of the cab while another drove, a team of two could get cargo from the Southeast to Los Angeles in not much over 40 hours, or from New York to the West Coast in less than 60. Figuring that somebody would pay extra for this sort of service, they started their own firm in 1986 with 48 trucks, and soon spotted an opportunity in nearby Georgia, where local carpetmakers wanted to compete in Western markets. Says Quinn: "They wanted to leave Friday night from Georgia and be on the street with carpet in L.A. Monday morning." As early as 1991, U.S. Xpress had driver teams who did nothing but back-and-forth nonstop transcontinental runs.

Through the '90s the company acquired Southwest and ten other trucking-related businesses. Today it has 5,300 trucks and 12,000 trailers, operated by some 5,900 drivers. Long-haul truckload shipments are the prime revenue generator. But the company also provides fleets dedicated to deliveries for single shippers such as Dollar General and has begun to build regional operations for short runs from, say, a warehouse to a store.

U.S. Xpress has consistently been among the first truckers to try anything new. Back in the '80s it was one of the first to use satellite technology for two-way communications with its drivers, enabling the company--and in more recent years the shipper--to know where every load is and whether it's on time. These days its trucks are rolling bundles of electronics: Anticollision radar, sensors that detect vehicles in the driver's right-side blind spot, and governors that reward drivers, who are paid by the mile, by allowing them to go 70 mph instead of 68 if they are fuel-efficient.

Tooling 40 tons of truck down an Interstate no longer requires a burly driver. Steering is powered. Shifting through ten speeds, once the toughest thing to master, is done by a computer. The cabs are commodious. A 6-footer can stand up. The beds (one comes down like a Pullman sleeper) are roomy, and there are spots for a small refrigerator, a microwave, and of course a laptop, for those who want to install them. "The goal," says Norman Thomas, U.S. Xpress' vice president for information systems, "is to make sure that the driver's comfortable, happy at the job, and taking care of the revenue. Drivers can lose you a \$100 million account with words, actions, and how they do business."

A long-haul driver can also tire of being away from home. U.S. Xpress won't reveal its turnover, but a trucking company can lose well over half its drivers in a year. To enlarge the pool, U.S. Xpress has been particularly aggressive in recruiting women. It also tries hard to hire couples, most of them married and many, especially when starting out, with no home but the truck. If they hustle, they can earn as much as \$110,000 a year. But the relationship has to be solid to survive all that togetherness.

For a time, U.S. Xpress and all its major competitors experimented with "logistics services," vying to provide transportation solutions for customers rather than to simply move freight. But last year the six big publicly owned truckload carriers (now five, following a merger of Swift and MS Carriers) joined to form Transplace, which combined the logistics departments of all the founding companies. Transplace now builds supply chains for customers like J.C. Penney and Office Depot, using trucks from hundreds of companies in addition to those of its founder-owners.

For U.S. Xpress, Transplace serves as a source of loads, more capacity, and, it hopes, future profits. It could sure use them. The carrier's net income was battered in 2000. On an 11% increase in revenues, to \$787 million, after-tax profits fell more than 80%, to \$2.1 million. That was all of a 0.5% return on total assets. This year U.S. Xpress has picked up enough new business to offset reduced orders from older customers. As a result, revenues have been flat despite the national slowdown. After the carrier lost a horrific \$1.2 million in 2001's first quarter, its fuel and other expenses declined a hair, and some price increases stuck. As a result, the bottom line turned black, with \$691,000 in combined second- and third-quarter profits. Not much for a company with \$429 million in assets but better than being in the red.

To get back to decent earnings, U.S. Xpress is trying to cut expenses. It also wants to make entrepreneurs out of perhaps half its drivers--and thus convert some fixed costs to variable costs--by helping them become owner-operators. So far, only 800 have gone with the deal. The biggest chance for profit improvement is to use the assets, walking as well as rolling, more efficiently. Right now the company is utilizing only 86% of its drivers' time and some 74% of the hours that its trucks could be moving. The big problem is "dwell time" at customers that leave drivers waiting to load or unload.

Debbie and Austin Hogan, who both retired after 20 years as first sergeants in the Air Force to start second careers, are one of the company's married teams. Recently Debbie piloted their big 18-wheeler into Brooklyn. Despite Austin's conviction that it couldn't be done, and to the astonishment of some watching car drivers, she threaded the 72-foot truck between elevated train columns to make a tight turn into a narrow street and pull up with a shipment at an electronics dealer's store. But once there, they waited six hours to be unloaded.

Fuller and Quinn profess to see good in the current downturn. Fuller says the small price-cutting trucker who has been driving used equipment has been "purged from the marketplace." The larger, surviving carriers were running out of capacity just before the economy slowed. U.S. Xpress is still replacing vehicles, but its fleet and those of its competitors aren't getting bigger. Says analyst Broughton: "As the economy rebounds, the leading truckload trucking firms will make record amounts of profit."

Getting traction on the rails

For a U.S. manufacturing manager listening to a railroad executive talk about better asset utilization, on-time deliveries, and outsourcing, the first reaction has to be "Where have these guys been?" One answer is that they've been busy trying to digest the mergers that have consolidated most of the North American rail business into four large lines in the U.S. and two in Canada.

The delays that followed the 1996 combination of Union Pacific and Southern Pacific were so bad they made the 11 o'clock news. The more recent

problems in the East after Conrail was divided between CSX and Norfolk Southern didn't attract as much attention but sure riled shippers. So far, the mergers have done little to reverse the flow of profitable cargo from rail to road. The trains still get the cheap bulk shipments like coal and grain. Trucks get high-value cargo and over 85% of freight revenues, vs. 6% to 7% for the railroads.

You'd think the railroads would have it figured out by now. But they all came into the '80s and the cold shower of deregulation stuck with a huge network built when prices and profits were determined more by bureaucratic dictates than market mechanisms. They also came towing traditional ways of doing business and burdensome union work rules. They've made progress with the unions, decoupling the caboose and reducing freight train crews from five to two. But the biggest problem remains: an aging blue- and white-collar work force that has "always done it this way."

One symbol of change on the rails is Matthew Rose, CEO of Burlington Northern Santa Fe. The line, operating on 35,500 route miles of track in 28 Western states and two Canadian provinces, took in \$9.2 billion in revenues last year, making it second in size to Union Pacific. Rose was just 41 when he got the top job last December. And while he started working on a railroad right out of Missouri State, his resume lists a detour with trucker Schneider National. Rose says his aim is to create a work force with a different mindset, "one conditioned to think about return on capital, about productivity improvements, about everything."

What Rose is really asking railroaders to think about is the customer, something none does well. If you're Du Pont or Georgia Pacific, you get attention. But otherwise, listen to Paige Prendergast, director of transportation for Montana's Pioneer Oil Co., a small liquid-asphalt marketer with 200 tank cars. She says, "The railroads preach customer service, but trust me, the only customer they're focusing on is themselves."

Rose claims with considerable justification that BNSF and the other railroads have been doing a lot more a lot better than it might appear. They have wrung "literally billions of dollars out of costs," he says. That has enabled his line to survive and even invest in new facilities and more efficient locomotives and freight cars even though freight revenues, in constant dollars, have declined, from \$20.80 per thousand ton-miles in 1994 to \$16.60 in 2000.

If the sole issue was the cost of moving a ton of something a mile, the truckers couldn't lay a finger on the railroads. A two-man train crew can haul more than 200 containers that would otherwise require 200 trucks and drivers. The catch is the cost of getting freight to and from the train. Just as important is reliability. Railroads haven't been reliable for so long that it's hard to convince shippers that they can be. One clue that it's possible: UPS is BNSF's largest customer and last year paid the line about \$350 million for intermodal service. Nobody shows up late for that shipper.

The railroads have also been increasing their share of the automakers' business. This past summer Norfolk Southern added equipment and designed a service for both Chrysler and General Motors that diverted the equivalent of 15,000 car-carrier truckloads, about 90,000 vehicles, from road to rail in just the first ten weeks of operation. NS has also been taking back traffic on the upstream end of GM's supply chain by consolidating shipments of parts and delivering them just in time.

To provide better service for any shipper that wants it will entail still more investment in new facilities and equipment. But no railroad can continue to upgrade unless it has brighter financial reports to reassure investors and lenders. With \$980 million in after-tax profits, BNSF led its industry last year in total earnings. This year profits for the first three quarters dropped 13%, and return on assets slipped below 3%. NS looks a lot better this year than last. Its after-tax profit for nine months was \$260 million, on \$4.6 billion in revenues,

up 56% over the same period in 2000. But that's still just a 1.8% return on assets.

One way to boost return is to get by with fewer assets. Rose says, a bit ruefully, "We simply have more railroad than we can afford to maintain." While BNSF and NS have been laying parallel rails on heavily traveled routes, elsewhere they have been abandoning track or turning it over to short-line operators. NS is well along on a plan to sell or scrap more than 12,000 freight cars. It has also been shedding entire operations, such as a freight-car repair and maintenance shop in Hollidaysburg, Pa.

With the problems of the mergers mostly behind them, all the lines have been running more punctually, especially with intermodal shipments, their best opportunity to capture a bigger share of the high-value freight that's now on the highways. NS has spent \$380 million building a new intermodal yard at Austell, outside Atlanta, and sprucing up other facilities where trailers and containers are put on and taken off trains. Last year its intermodal customers suffered late deliveries about half the time. In the first nine months of 2001, tardiness was down to 10%. BNSF has gotten so cocky about its ability to keep on schedule with intermodal trains that it is guaranteeing arrivals. Customers willing to pay a 10% to 15% premium can get a money-back on-time guarantee on a dozen routes. This year the road has moved upwards of 1,500 carloads under the program. So far, it says, it has had to refund a customer's money fewer than two times out of 100.

The next step is to guarantee deliveries even when more than one railroad handles the shipment. Nothing messes up a schedule as much as time lost or loads misplaced at the handoff point from one road to another or from truck to train to truck. Chicago has been the worst case. Almost one out of three intermodal cars starts in, stops in, or goes through the city. But the yards for the Eastern and Western roads are in different places. Switch engines shuttle back and forth and, hard to believe, some containers are taken off one train, trucked across town, and loaded onto another.

In the past year the two Western roads and the two Eastern roads made deals with each other to provide "run through" transcontinental intermodal service: Trains move from coast to coast, sometimes with a change of locomotive, sometimes with only a crew change at the handover point. Much of it is being done to speed passage through Chicago, but run-throughs are also occurring at other points, such as Memphis and New Orleans.

Highway congestion, a huge and worsening problem for truckers, is a great opportunity for the railroads. But David Goode, CEO of Norfolk Southern, admits that getting more business won't be easy. To do so, he concedes, means providing "the service individual customers need in their own business to be efficient. And historically, rails, including us, have not done as good a job at that as we needed to do. So that's why we are concentrating on getting service levels up to where we can really aggressively capture business. If we can, and if we are disciplined on the cost side, we will get back to providing our investors a fair return. That's the strategy. You can say, 'Hell, that sounds pretty simple.' Well, it is." Who's to argue?

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