Intermodal—The Future

Jim Shattuck
Vice Chairman
Union Pacific Railroad Company

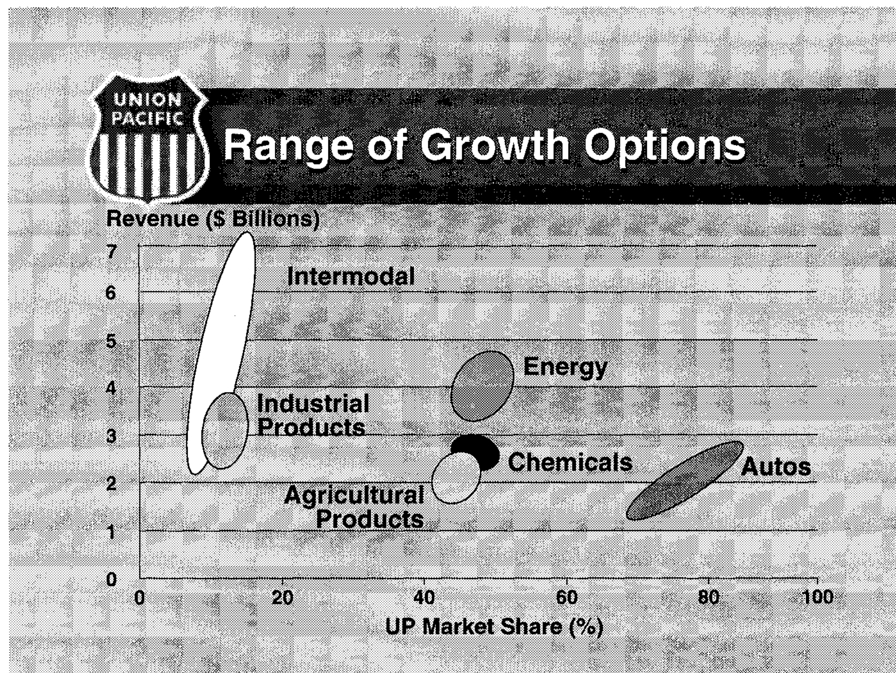
The Union Pacific (UP) currently represents three merged railroads. As we were putting the last piece together, we wondered many times if these mergers were really worth it, but we know now that they are. It is a lifetime deal, and we have a great foundation for growth. During the time we were putting the current UP system together, we developed a 10-year strategic plan, which took about a year to develop. We wanted to make sure that we optimized the use of our network by developing our strategy for the next 10 years. This discussion focuses on the intermodal piece of that strategic plan.

Examining the UP Business Mix

The UP is fortunate to have a good, balanced business mix with good growth opportunities. Intermodal represents about 16 percent of our revenue or $1.7 billion in 1999. Ten years from now intermodal will be a

Published by Digital Commons @ DU, 2000

significantly larger percentage of the mix. The UP intermodal business in 1999 is comprised of 44 percent international business. Typically, international customers want some container-yard capacity, and the UP service plan is based on ship arrivals and ship rotations. These customers expect reliable service, good velocity, and they will pay a premium based on service delivery. In the domestic segment, there are a lot of different types of customers. There are the asset owners, like Pacer, J.B. Hunt, and Schneider, and non-asset owners or intermodal marketing companies (IMCs). In this segment, they all expect reliable service and they want us to be easy to do business with. With this as background, what do we at the UP see as the future of intermodal? What role is intermodal going to play in our business as we go forward?

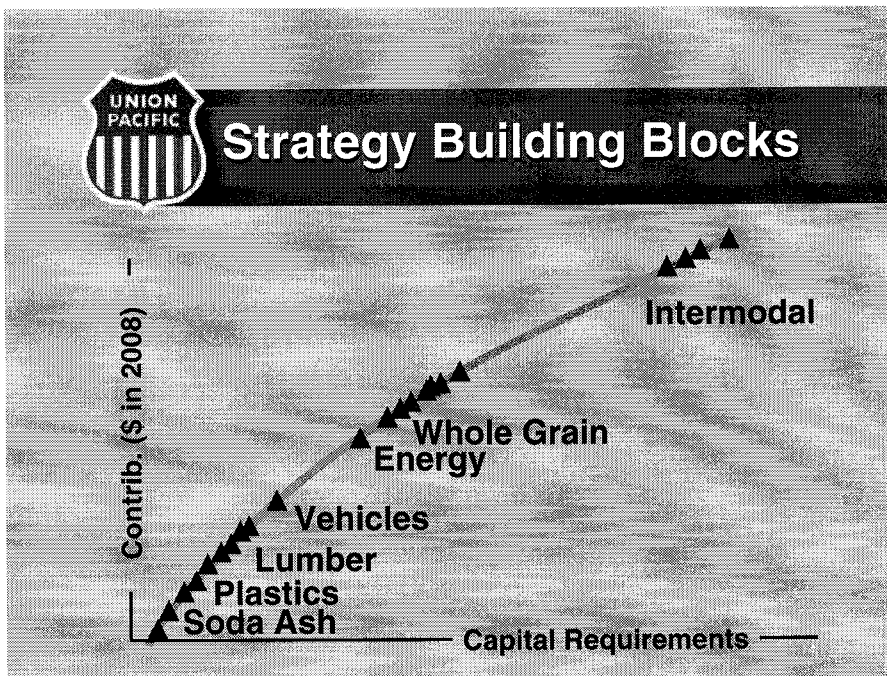


In the market assessment phase of the UP strategy development, we identified twenty-two different market strategies coupled with three different operating strategies: a selective, a yield management, and an aggressive strategy. We combined the market and operating strategies and developed five different portfolios. Then, we did an economic evaluation of the five portfolios to help us select a strategy. The intermodal segment was unusual because of the huge range of growth opportunity, from $2 billion to $7 billion within 10 years, with little shift in market share from truck. The same holds true in the UP industrial products area. The

growth is not as large as in the intermodal segment, but like intermodal, we currently have a small market share in this growing industrial products area.

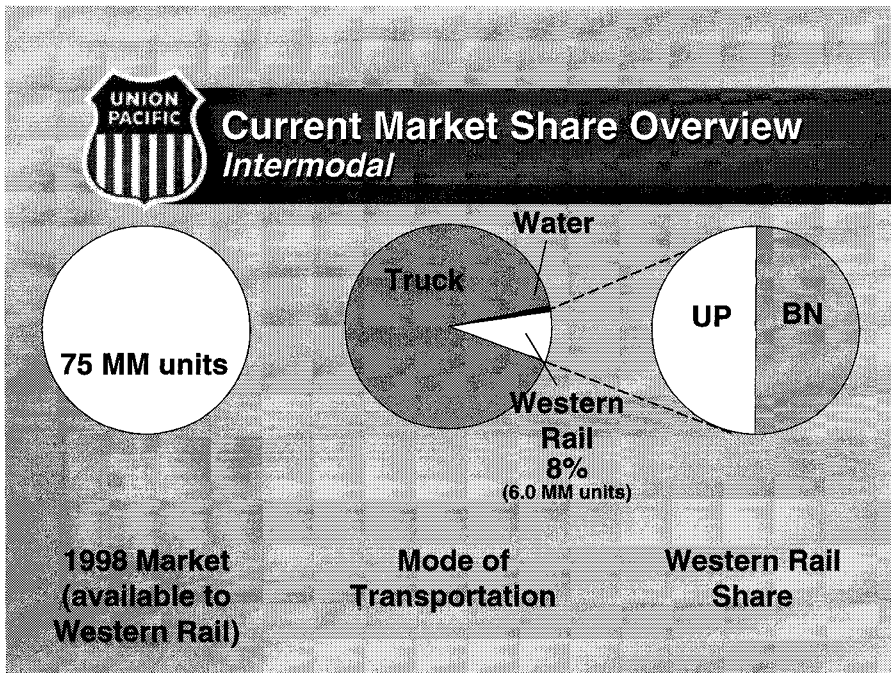
Growing the UP Intermodal Business

One of the consultants who we were working with had a concept called the "efficient frontier," which focuses on maximizing capital efficiency. As you move up the frontier, capital requirements are greater. This concept provided us with guidelines for establishing a combination of strategies. We may have an aggressive strategy for one market and a maintenance strategy for another. Intermodal fits the yield strategy and requires significant capital.



Looking at the history of intermodal at the UP, we had fast growth early due to the stacktrain, motor carriers coming into the market, and the development of IMCs. In 1993, with severe floods, our growth slowed. Our share grew again until we had our post-merger service crisis, when it flattened out again. We are now back on a growth track and are significantly exceeding growth of the intercity freight industrial production index.

The market available to rail in the western US is estimated at 75 million units. However, the western railroads have only 8 percent of this market, so we have a very little piece of the overall market. Currently, 1 percent is over water, 8 percent is on rail, and 91 percent is still on truck. The market share is large, but we are not competitive in many cases. The motor freight operators would like to use the railroads more, but our service reliability is just not there yet. We have to offer truck-like reliability if we are going to grow the intermodal business.



We must get variability out of our service. Looking at background information and our understanding about the future, we plotted three different strategies for intermodal. The selective strategy has a compounded annual growth rate of 6.4 percent versus the index of 5.6 percent. The yield strategy is in the middle at 12.2 percent growth, and the very aggressive strategy is higher still. The one characteristic of all these strategies is that they are all flat when they start out and then improve. A lot of this has to do with what is happening in other business segments, capital expenditures, and when we can bring facilities on line. The UP is focusing on the yield strategy.

Not surprisingly, as service improves, we will see more and more opportunities to grow the business in intermodal. Service is the real key.

The question is how do we get the right combinations together in our yield strategy to leverage our franchise and provide a level of service that will allow us to grow?

Meeting the Service Imperative

Service is imperative for profitable growth. As a result, the UP is focusing on investments that help to address service. We are identifying where we have bottlenecks, what corridor we should play in, and, with a yield strategy, whether we can manage different levels of service. Meeting the service imperative is not simply spending money. A great deal has to do with management processes, with being disciplined, and with having priorities and a realistic transportation plan. Equally important is how we are organized for decision-making.

Technology is another key to the future of the UP. The next generation of computer-aided dispatching addresses optimizing the use of our network. Positive train separation and positive train control will allow us to get more capacity and improve asset utilization. Technology will have a big role to play as we move up the service spectrum. Finally, we have to put iron in the ground, spend capital on the right projects, figure out how to get through Chicago, and have the discipline to execute our transportation plan consistently—recognizing we must be selective because we cannot be everything to everybody.

We decided to take advantage of the stacktrain economics and really focus on containerization. We know that we have to put some good services together with our eastern partners—through services that are seamless going east. We must tie our expansions to markets we understand, making sure we understand where to invest in new facilities. Finally, we need to get a product out there that is, in fact, truck-competitive.

Examining the Risks

What are the risks to this strategy? Not being able to meet our service requirements is a real downside risk. On the other hand, there is probably an equal upside, if we can do better than an 85 percent service index. In the pricing area, we have to be able to get prices that allow us to reinvest in the business. There are risks on both sides of the spectrum. Truck economics deal with the new technology in the truck world, such as fuel efficiencies, truck size and weight, and the use of double and triple trailers. On the upside, truck economics have to do with quality of life issues and drivers. There are risks on both sides here as well.

There is a well-organized customer campaign that offers a misleading message: "All we want is increased competition." It is the view of the railroad that what these customers really want is a major reduction in rail

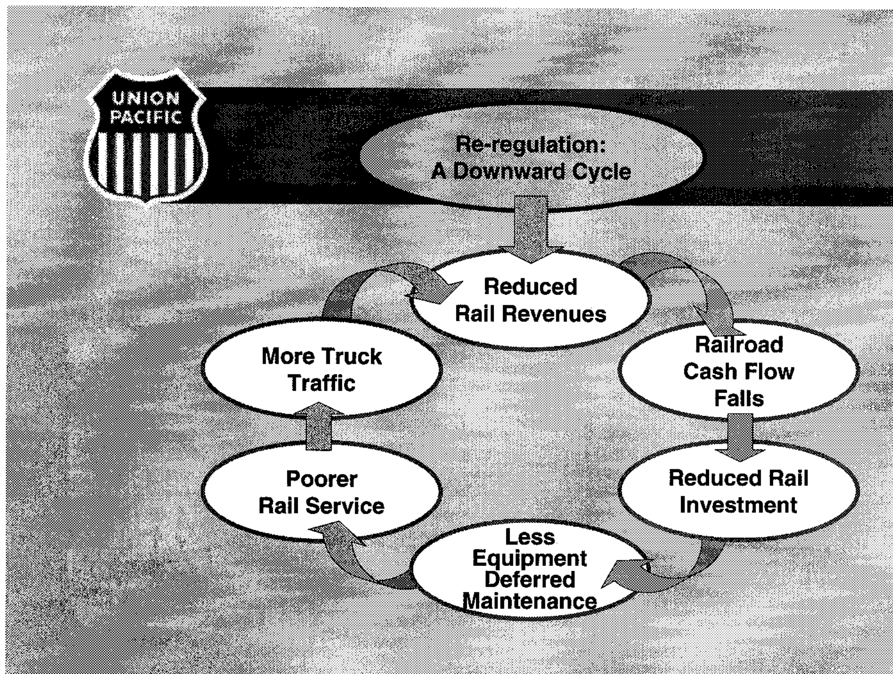
rates for certain shippers by seeking legislation that would force one railroad to allow a second, competing railroad to use its facility, when the market would not support the construction of a facility by the second railroad. This will result in a downward cycle for our industry.

Focusing on the Future

The Staggers Rail Act of 1980 was enacted and the results have been amazing. Prior to the Staggers Act

- 20 percent of our industry was in bankruptcy;
- the average return on investment was less than 2 percent;
- there was a high accident rate; and,
- there was a capital shortfall of $20 billion.

Since Staggers, our productivity has increased 170 percent (80 percent of which was returned to our customers in terms of reduced rates); the accident rates have declined by 70 percent; and we have reinvested some $230 billion to revitalize the railroad industry.



This is a very serious issue for our industry. We understand that some have different views—some have characterized the re-regulation campaign as a contest between customers and the railroads—it is not. It is a fundamental policy issue: Should Congress mandate changes in the na-

tional rail policy that will reduce revenue and investment funds by lowering rates for certain customers? The railroad industry is on the way back. Re-regulation would undermine the gains customers and railroads have made as well as the ability of railroads to raise the capital required to expand, to become more productive, and to provide the reliable service that we are all striving for.

It is up to us, as an industry, to take advantage of the opportunities that we have in the intermodal world. There is a huge revenue upside. We must have the discipline to focus on service, while recognizing we cannot be everything to everybody. The intermodal market offers the Union Pacific tremendous growth opportunities. Achieving the potential is up to us.