The railroad industry and the Chicago Way

In the movie version of "The Untouchables," Elliot Ness is given advice about facing his adversaries.

"He pulls a knife, you pull a gun. He sends one of yours to the hospital, you send one of his to the morgue. That's the Chicago Way."

Chicago has always been the center of the North American railroad industry. It seems the Chicago Way has become how major railroads deal with each other since Burlington Northern Santa Fe and Canadian National announced their intention to merge.

Next week, the Surface Transportation Board will hold a hearing to promote dialogue between those affected by the merger. In fact, the number of carriers, shippers, industry organizations, employees and other interested parties has been so great that the forum will last most of the week.

The industry will be watching STB Chairman Linda Morgan carefully for clues about the board's reaction to the merger. Although the STB has determined to include "downstream" effects on the entire industry, the basic statutory oversight process remains unchanged from recently approved mergers.

For a variety of reasons, the current industry environment is unstable.

The proposed BNSF-CN merger injected an increased level of uncertainty into the environment. The two companies had only just announced the merger when the CEOs of the other four major railroads denounced the proposed transaction in full-page ads.

To some observers, this tactic was no more than a delaying gambit. But it forced BNSF and CN to reply with a spirited defense of the merger.

In the future, railroad historians may review this period as world historians study August 1914, when a series of events led the world to the cataclysmic Great War.

BNSF and CN have already talked about guaranteeing service to customers. More important, many suspect that some sort of open access may be offered to win shipper support.

Then there is Wall Street. The current depressed nature of almost all railroad stocks greatly concerns the entire industry. The worries are also a factor in the depressed stock prices. Not surprisingly, the STB hearings will feature the testimony of several Wall Street financial analysts.

If BNSF and CN merge, future mergers are almost unavoidable. A decade ago, some railroads, their stock prices languishing, became acquisition targets.

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Santa Fe and Chicago and NorthWestern were two prime examples. Although they managed ultimately to rebuffer the takeovers, theirs were cases of winning the battles and losing the wars. The defense process positioned them for inevitable integration with another railroad.

It is hard to believe that less than a year ago, railroads were considered attractive investments. Last May, an article in Barrons, the week before the Conrail split, considered CSX and NS as growth stocks. Last summer, Fortune described railroads pouring investment into new track, locomotives and information systems.

Although capital-investment plans for railroads continue, they are already being scaled back. Some of the money is going to buy back stock, which benefits shareholders but can affect long-term franchise viability.

We cannot ignore the force of legacy. The current railroad chief executives can each take credit for notable achievements. But without the benefit of hindsight, there does not appear to be any one individual who stands apart from his peers — although at various times certain CEOs have held the industry spotlight.

(This is in sharp contrast to the last two generations of railroad CEOs. For example, Stanley Crane made Conrail work, and Lou Menn made the BN merger succeed after the Penn Central debacle.)

Finally, there is a force in the railroad industry which allows railroads to persevere. Some might call it inertia.

In today's dot.com world, railroads have a unique rhythm and manner of operating. Many also have a consistency of culture.

In the past 20 years, railroads have had to overcome the intro-spective nature of this culture in order to attract and retain customers. Some have been more successful than others.

Many customers worry about railroad-industry turmoil and the change in focus that can result.

In any company, when times become difficult senior management falls back on its experience. For railroads, this usually means a return to internal concentration.

Customer focus is sacrificed as railroads struggle with their internal problems. Customer contact is often limited to seeking support of positions, pro or con, in STB proceedings. The industry survives but it fails to flourish.

The issues facing railroads today require consensus, and there exists real concern that the industry may be unable to address external threats as it tries to resolve the BNSF-CN internal dispute. Next week's hearings will simply be the beginning of a lot more drama to come.

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