Planes, trains and competition

A flurry of business stories whipped through the news during the second week of January, and many of them apply to the freight industry.

The U.S. Postal Service and FedEx formed a new operating alliance. These two companies, who will continue to operate independently and maintain separate services, will work together for the delivery of domestic parcel shipments. This agreement is expected to generate $7 billion for FedEx and result in savings of $1 billion for the USPS over its seven-year term.

The deal seems to perfectly exemplify "cooperation" — a term invented by Ray Noorda, the founder of Novell, to refer to a business cooperating with its competitor. Freight consumers require a growing list of services. Since it is difficult for one company to provide all solutions, companies may need to put aside past differences to benefit mutual customers.

Alternatively, that same week saw United Parcel Service announce its purchase of Fritz Cos. for $450 million in common stock. UPS is expected to use this acquisition to offer a wider array of services for moving both light packages and heavy freight and to compete more effectively against international rivals (i.e., Deutsche Post) which offers one-stop shopping.

Students of transportation history will sense some irony here. UPS used its appreciated stock as currency in this transaction. In the early 1990s, Fritz depended on similar currency to finance its ill-fated acquisition spree. The failure effectively to integrate its purchases so weakened the company that Fritz seemed to have no choice but to seek a buyer.

We also saw AMR, the parent company of American Airlines, announce its planned acquisition of the assets of Trans World Airlines and assumption of outstanding aircraft operating leases for approximately $500 million in cash. This would mark the demise of yet another icon of American transportation history, the result of extended periods of poor management. Past success was no guarantor of future glory.

In a simultaneous deal, American said it would purchase approximately 20 percent of USAirways — mostly the Washington/New York/Boston Shuttle. To railroaders, the shuttle now resembles a main line track split between two railroads — an undivided, one-half interest. To shipping companies, the alternating plane operation makes the shuttle look like a vessel sharing agreement.

To many industry observers, this latest event in the airline merger saga resonates with echoes of railroad industry drama with the Surface Transportation Board. Over the past 18 months, the STB has sought to put in place new rules governing what is expected to be the final round of railroad mergers. Most observers feel that North America will ultimately contain two transcontinental railroads.

The STB’s process, Ex Parte 582, has been scrutinized by all and final rules are due this June. While additional mergers are considered inevitable, the terms under which these mergers will be granted, and rail-to-rail competition is maintained, are still subject to considerable debate.

For that reason, the deals involving American and United may set a precedent. These two companies will control almost half the domestic market. Proponents of the transaction argue that it improves competition because it incorporates airlines which could otherwise no longer compete. TWA was bankrupt and US Airways was too small. This sounds like the argument for UP acquiring SP and CNW.

In an argument sure to be used by railroaders, Clyde V. Prestowitz Jr. has suggested that competition between apparent duopoly members in capital-intensive industries is often severe — and beneficial to consumers. (He uses Boeing and Airbus and Intel and AMP as initial examples). He asserts that airline consolidation, by
creating national networks which allow consumers to reach more destinations without switching airlines, benefits travelers.

Not only is service improved, but it is also 55-percent cheaper than interline movement. Prestowitz claims that the consolidation of the industry into three airlines would increase competition in 74 percent of markets, decrease it in 13 percent and have no effect in the remaining 13 percent.

Interestingly, Prestowitz, who gained fame in the 1980s by warning about how America was handing its future to Japan, fails to note the obvious expansion of competition should we allow foreign carriers to serve the domestic market.

Railroads are certainly studying the airline news along with two other compelling business items.

First, the Federal Communications Commission gave final approval to the $117 billion merger between America Online and Time Warner. Like airlines and railroads, this merger involved asset-based network-operating companies. The FCC imposed conditions on instant messaging, a powerful online communications channel, and also placed limits on AOL’s dealings with the largest cable owner, AT&T. Transportation observers noted with special interest an earlier ruling by the Federal Trade Commission, which approved the merger with conditions requiring Time Warner to open its high-speed cable lines to AOL’s competitors before AOL itself would be permitted to offer service over those same lines. Some considered this “open access” debate similar to one which has engaged railroads. But AOL was able to make some deals by itself (with Earthlink) that allowed this issue to remain basically unresolved because the technology is changing faster than the ability to regulate it.

Finally, there is the current power crisis in California. Many observers point to it as a failure of deregulation. Many are calling for the government to control the market again. Again, the similarities to rail are striking.

The above-mentioned complaints miss the point. The California legislation passed in 1996 was not deregulation — it simply modified existing regulation rules. The legislation required utilities to sell their power plants, splitting the manufacturing and delivery. This strategy has also failed as a strategy for railroads in England. It also forbade long-term contracts and required utilities to buy power in the spot market. Rather than simplify market mechanics, it complicated them.

Perhaps the only similarity is that "deregulation" was viewed as a way for consumers to benefit from excess capacity. Ultimately, market growth always consumes that capacity, mandating new investment. This has been lacking in California — and in many sectors of the transportation network.

For continued growth in the economy, we need ongoing development of infrastructure. In the coming years, we may see this problem repeatedly reported in the news if we don’t start implementing a strategy today.

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