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On Track for Growth

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How the railroad industry is reinventing itself as a customer-conscious business.

ON Track FOR Growth

by Andrew Tipping and Justin Zubrod

As advertising slogans go, the 1984 "We're getting there" campaign from British Rail ranks among the worst of all time. British Rail was then a long-distance train operator wholly owned by the government of the United Kingdom. The railroad intended the ads to offer an earnest portrayal of slow, steady improvements being made to a service known for its decaying infrastructure. But for a skeptical public forced to endure overcrowded train cars and frequent delays, it sounded as though British Rail had simply given up.

At that time, this dismal outlook — ever-lower expectations and diminishing service — was fairly typical of government-run railroads around the world. But today, the story has begun to reverse. Railroads from North America to New Zealand are becoming customer-centric, service oriented, and quality focused. The current state of British rail transport is emblematic of the industry's transformation. Formerly disgruntled rail passengers can now ride faster, more modern, more reliable trains from London to Manchester, Birmingham, Glasgow, and other U.K. cities. Travelers going to the continent can take the Eurostar, the high-speed passenger rail service between London and European cities that has commissioned interior designer Philippe Starck to make lounges so stylish that they are the envy of airlines. All of these trains are operated by companies spun off during the privatization of British Rail that took place between 1994 and 1997.

The stakes involved in creating top-quality rail service are high, and they are getting higher. People are traveling more, and increasing amounts of freight need to be shipped speedily. The skies and roads are plagued

Illustration by Daniel Pelavin


PELAVIN

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by congestion; furthermore, planes, trucks, and cars spew carbon emissions. The rails offer a more reliable, lower-carbon alternative (particularly with electric rail). And if rail service can be brought up to 21st-century standards, then it can serve as an operating model for other forms of infrastructure and utilities.

The worldwide revitalization of the rail industry has been attributed to the effect of privatization. But although privatization can make a difference, it isn't a prerequisite for success in passenger rail service — or even the most critical factor. Discernible, reliable improvements are taking place under all three forms of governance: public-sector agencies, private-sector rail corporations, and public–private hybrids. In the end, skillful management and a dedication to sensing and meeting the needs of the market seem to matter more than the structure of ownership. Evidence for this assertion includes the impressive results coming from the U.S. government–owned Amtrak (National Railroad Passenger Corporation) and its Acela passenger service; the private Canadian freight railway CN (formerly the government-owned Canadian National Railway); government-owned railway systems in New Zealand, Hong Kong, and Singapore; and public–private partnerships such as metro lines in Beijing and Shenzhen, China.

The rail industry has long struggled with the challenges of managing for growth and customer service. But now, railway organizations like Amtrak and CN are leading an industry-wide transformation. They are escaping from both overly restrictive regulations and the self-imposed one-size-fits-all approach to serving their customers. These companies are responding to the growing complexity of their markets and increasing demand for higher levels of service and reliability. And in doing so, they are mapping out a path not only for other railroads but for any sector that needs to be more market-facing, responsive, and visionary.

Overcoming Ingrained Maturity

Reaching this point hasn't been easy. Public transport providers — notably passenger railroads — and their closely related postal and freight counterparts have frequently stumbled, often because of government interference. For instance, even though Amtrak has been highly innovative and successful in its Northeast and California corridors, it has been obliged by law and political pressure to maintain other routes across the country that are not profitable, forcing it into a money-losing position year after year.

The railroad industry has existed for almost 200 years; indeed, the first modern corporations were railroads. Andrew Carnegie, Cornelius Vanderbilt, and the original Standard & Poor's all built their enterprises through the growth of railroads. But the industry went through a moribund patch starting with World War I, in which ridership around the world dropped wherever the automobile was introduced. Mass transportation, and rail in particular, became perceived as a "mature" sector, with less opportunity for the type of product development seen in fast-moving industries such as computing or telecommunications. Not prime hunting ground, according to conventional wisdom, for innovative marketers.

This trend finally began to change with the development of high-speed rail transport in 1964 in Japan and 1981 in France. These rail systems broke new ground by promoting passenger services, mimicking airline-style marketing campaigns, and seeking to

Railroads have had to become customer savvy — a significant evolution for companies that did no marketing for most of their history.

understand and provide the amenities that customers wanted. The success of the government-owned French National Railway Company (SNCF) gradually inspired other European countries to establish high-speed rail systems. In Japan, the state-owned Japanese National Railways fell into debt in the 1980s, was privatized (beginning in 1987) as the Japan Railways Group, and then recovered. Even so, despite the generally strong reputation of the rail systems of Europe and Japan, it has taken more than 40 years for the idea of high-speed, customer-centric train lines to catch on globally.

From the experience of the past few years in particular, key lessons are emerging. The best railway organizations, whether public or private, are absorbing both new computer-based technologies and proven leadership talent from the most innovative companies in industries such as manufacturing and airlines. This makes it easier for them to move from a government model that concentrates on merely managing routes and setting prices for the masses to a market-oriented mindset that allows them to differentiate their services for different kinds of customers and to charge accordingly. In becoming more market-facing, these railroads have had to become customer savvy — a significant evolution for companies that did no marketing for most of their history. This in turn required substantial organizational shifts: Companies that thought of their basic business as "wheels on rails," or one-size-fits-all utility offerings, had to learn to build product and service offerings to meet specific customer needs. They had to segment the market, as any customer-aware company would have to, and cater to the most profitable segments. To accomplish this, they had to become capable of making successful acquisitions, and of starting new businesses and services from the ground up. This seemingly impossible transition turned out to be very possible — with a shift in management attitude.

New Zealand's Privatization Lessons

There is no universal path to commercial success, but there are certainly signposts set out by railroads that have already made the journey — as well as the remnants of previous failed attempts. For instance, the New Zealand Railways Corporation's success after becoming privatized in 1993 has served as a model for many other railroads, including those in North America.

At first glance, New Zealand presents many obstacles to the railway operator who hopes to be profitable. New Zealand is a small country of fewer than 4 million people living on two narrow islands. It has a high cost-to-serve environment: difficult, mountainous terrain; seismic geography; extremely circuitous routes requiring slower, smaller "narrow gauge" lines; and short distances between markets, all in a country with mandatory union participation. Moreover, because railroads usually make money hauling large volumes over long distances, it is a major challenge to operate a profitable railroad in a country with a small farm economy, low demand, and a small industrial base. And, indeed, during the 1980s, the New Zealand Railways Corporation (then owned entirely by the national government) had problems — declining productivity, growing railway losses, and an increasing government subsidy. More important, the true cost of transport in New Zealand was high relative to that in other countries and was continuing to rise, which had a negative impact on the country's industrial growth and economic attractiveness.

Thus, the government was thinking not just of

Inside Acela's Success

Amtrak's shining star and the most visible result of its new emphasis on meeting market needs is the high-speed Acela, which has grown passenger figures year-over-year since 2000. Congress approved its creation in 1997, during a rare pro-Amtrak administration, inspired by France's Trains à Grande Vitesse (TGV) and Japan Railways' famous Shinkansen bullet trains. Traveling at speeds up to 149 miles (200 kilometers) per hour, the Acela is slower than the TGV, but it is the fastest train in North America.

Amtrak's initial premium offering in the Northeast Corridor, from Boston to Washington, D.C., had been the Metroliner: a high-end, branded service first offered by Amtrak's predecessor Penn Central in 1969 targeting businesspeople. In the mid-1990s, when it came time to upgrade the infrastructure and the rolling stock for the Metroliner, says Fred Weiderhold Jr., Amtrak's inspector general, Amtrak decided to update the entire service. From New York City to Boston or to Washington is prime high-speed train territory: A journey time of three to four hours from downtown to downtown competes well against air travel, especially with the strict post–September 11, 2001, security regime in U.S. airports. Consider the Eurostar high-speed rail service that links London with Brussels and Paris; it has captured two-thirds of the traffic on its routes. Amtrak has grown similarly dominant in the Northeast Corridor. Of the 10,000 daily passengers traveling between Washington and New York by either plane or train, 54 percent are now using Amtrak, up from 45 percent before the Acela was introduced.

Although there was an initial jump in Amtrak ridership when it was introduced, the Acela hit some early snags. A series of highly publicized technical glitches, including the discovery of cracks in the train's disc brakes in April 2005, forced Amtrak to take the entire fleet of 20 Acela trains out of service for five months. And on-time arrival records that dipped below 50 percent in 2003 bruised the Acela's reputation. Today, however, the Acela has an on-time rate of 88 percent, and it is shooting for 90 percent in 2008. "Basically, we took all of what we call the 'delay minutes' and we assigned ownership of the delays, minute by minute, to the respective Amtrak department: Is the train delayed because of a rolling stock [train car] failure? Is it something that belongs to the infrastructure? Is it something that belongs to the customer handling? Why is the train late, and what can we do to consistently improve this premium service for our passengers?" says Weiderhold. That analysis made each part of the system

the rail sector but of the economy as a whole when it converted the railway to a corporation with a private-sector board. It brought in new leadership, eliminated government subsidies and interference in operations, gradually removed the constraints on trucking and other measures that had protected the railroad from competition, and sold the corporation to outside investors in an initial public offering. By 1996, three years after privatization, the company's revenue had increased from NZ$489 million (US$337 million) to NZ$572 million ($395 million), labor costs had been reduced from 46 percent to 34 percent of revenue, and operating profits had more than doubled, from NZ$54 million ($37 million) to NZ$111 million ($77 million). The railroad also saw an explosion of new and creative services in both passenger travel and freight transportation, including just-in-time freight delivery, value-added logistics, and new equipment and pricing schemes. Creative branding and marketing approaches for commuter and long-distance transportation won a number of awards in marketing, sales, and advertising.

But there is also a cautionary tale in the case of New Zealand Railways' privatization. From about 2000 on, its financial position deteriorated markedly, and increasing debt and declining margins seriously undermined its financial sustainability. The struggle was the result of increased non-rail competition, with too many operators charging too little for freight, primarily through aggressive pricing. Lacking cash, New Zealand Railways did not invest sufficiently in its rail lines. Ultimately, the government stepped back in and renationalized the network of rail lines for a purchase price of NZ$1, recognizing that a rail system couldn't operate effectively when it did not have a truly competitive environment.

A lesson here, then, is that governments are not, by definition, the enemy; they can be capable and even visionary operators. Governments have played a similarly positive role in such locations as Hong Kong and Singapore, where mass transit organizations have been highly effective and competitive under government responsible for a portion of delays and to work across functions to drive up overall on-time performance.

Thanks to these improvements and a comprehensive advertising campaign, the Acela has regained its ridership. During Amtrak's fiscal year 2007, which ended in September 2007, Acela's ridership was 3.2 million, up from 2.7 million in the previous fiscal year.

And Amtrak continues to push its Acela services forward. Further positioning the service as a direct competitor to airline shuttle flights, Amtrak recently added another weekday Acela round trip between New York and Washington, which stops only in Philadelphia, reducing the trip by 15 minutes. The company is also working on what Weiderhold calls the "platform product" — customers' experience from the time they enter the station to the moment they arrive at their destination. Washington's Union Station, for instance, is an architectural jewel and looks great upon entry, but the gate areas are uncomfortable and overcrowded. "When you pass through that station to the gate areas, you almost get 'herded' in there," Weiderhold says. "We haven't solved the space and gate problems yet, but we will. We want that whole Acela experience to be seamless and we want it to be top-shelf."

On the train itself, Amtrak is considering upgrading to more comfortable seats and better food and beverages. "Whatever we can do to differentiate the product for the prospective customer, especially as it relates to what the airlines are offering, I think it's smart money," Weiderhold says. "We also do whatever we can to make the traveling time productive, in a way that customers can't get if they're flying or driving. For instance, we're trying to launch a program with T-Mobile to provide continuous Internet access."

Amtrak has set ambitious goals for the Acela, hoping to reach US$500 million in annual revenue on the line in fiscal year 2009, accounting for about one-quarter of Amtrak's total passenger revenues. This compares to approximately $400 million for 2007. Weiderhold believes there is further opportunity to penetrate, in particular, the New York–Boston route. And the company is not limiting its vision to the Northeast: Weiderhold sees potential for high-speed trains in other U.S. markets, such as those serving travelers between Los Angeles and San Diego. "I think passenger rail in this country is going to enjoy a resurgence," Weiderhold says, "and finally find its proper place in the intercity transportation system."

— A.T. and J.Z.

ownership. Those transit systems have, of course, benefited from high population densities, but Singapore's policies have also buttressed ridership. Singapore has granted long-term rail franchises to the government-owned SMRT and more recently to a private operator, SBST, a major bus operator in Singapore that has expanded into rail. In this way, the government has been able to promote competition.

The New Zealand model has also imparted lessons to rail operators in North America. On the freight side, for instance, CN has freed itself from the strictures of government ownership. In doing so, it has proved agile and responsive to the changing needs of its markets, providing end-to-end supply solutions for its customers and creating new demand in the process. In general, the freight operators, most of them private but heavily regulated since their founding, have become highly effective organizations over the past decade. They have grown their top lines and improved profitability while investing substantially in new technology. As a result, they are attracting major investments from the likes of Warren Buffet and Bill Gates; Gates, in fact, is the largest investor in CN.

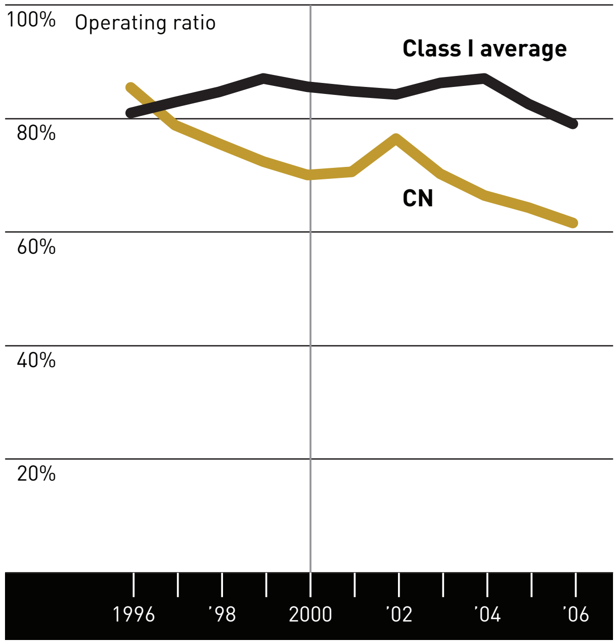
But market responsiveness does not work just for privately held operators. Amtrak's Acela Express high-speed train is proving surprisingly successful, steadily building its ridership in the seven years it has ferried passengers along the Northeast Corridor. Like CN, Amtrak has shown itself able to drive growth in mature markets and to create opportunities in an industry that has only recently recognized the need to compete for business.

Canada's Transcontinental Turnaround

Since it was privatized in 1995, CN has gone from being a stodgy Canadian Crown corporation to becoming one of the leading railroads in the world by identifying and addressing customer needs. In a dramatic improvement from the era in which goods placed on a train seemed to disappear until they mysteriously reached their destination weeks later, now customers can track their freight

Exhibit 1: **Operating Ratios for CN vs. Class I Freight Lines**

Strong management at CN has led to high profits and low operating ratios, especially compared to the average of the other Class I freight railroads.



Note: Class I data for 2006 is estimated.

Source: Booz Allen Hamilton

on CN just as they would with FedEx or United Parcel Service. Customer billing has improved, and CN has also demonstrated a sophisticated understanding of its freight customers' supply chain needs.

At the time of privatization, CN was a transcontinental railroad with track from Halifax to Vancouver, but it had only a limited presence in the United States, courtesy of its Grand Trunk subsidiary, which served the Detroit–Chicago corridor. The company's turnaround accelerated when it made several key acquisitions. The first was Illinois Central (IC) in 1998, which allowed CN to reach New Orleans and the Gulf of Mexico. Then in 2001, it bought Wisconsin Central, thus penetrating farther into the upper Midwest and plains states.

One important side effect of the IC acquisition was that IC's president, E. Hunter Harrison, became chief operating officer of CN. Widely perceived as a topnotch railroad operator, Harrison became chief executive officer of CN in January 2003. Under his leadership, the company made one more small but critical acquisition, in May 2004 — Great Lakes Transportation. At almost US$38 million per mile, the $380 million purchase of the company's 10.5-mile (17-kilometer) section of railroad near Duluth must rank as one of the costliest purchases in rail history. Yet the 10.5 miles in question completed the route from New Orleans to Chicago and onward to CN's transcontinental network north of the border, justifying its price tag.

This series of acquisitions allowed CN to become one of North America's most profitable railroad operators, with the lowest operating ratios (expenses as a percentage of revenues) of all freight carriers — in the mid- to low 70s, compared to ratios in the 80s for other carriers. CN has become adept at exploiting its market at a time when freight rail is facing capacity constraints, and it has been able to create higher value than the other major (Class I) freight railroads. (See Exhibit 1.)

Certainly, some favorable conditions in the industry have contributed to CN's success. North American freight rail has little bureaucracy and few track incompatibility issues to hinder travel over long distances. Ten-year railroad trends, published by the Association of American Railroads, show freight revenue soaring from less than US$35 billion in 1996 to $47.9 billion in 2005. Much of this growth can be attributed to the rise of imports from Asia, particularly China, which arrive at West Coast ports and need to be transported across the country. In addition, many power stations are switching from natural gas, which is delivered by pipeline, to coal, which travels by rail.

Another factor driving freight growth has been restraints imposed on the trucking industry. The short supply of truck drivers, regulations limiting the time they can spend on duty, and worsening highway congestion have made road haulage less competitive. But unlike trucking, rail cannot quickly expand, because the railroads must make massive capital investments simply to maintain and upgrade existing track, leaving little money for building new routes. Freight railroad operators are among the most extensive capital investors, with 15 to 20 percent of revenues on average reinvested in the track (which, unlike road or air routes, is not federally funded) and rolling stock (the locomotives and cars).

Capacity constraints lead to increased prices, but although there are still six Class I freight railroad operators in North America, competition has kept prices down. Instead, innovative rail operators have looked

CN has proved agile and responsive to the changing needs of its markets, providing end-to-end supply solutions for its customers and creating new demand in the process.

for new ways to squeeze more money out of their existing networks.

One key to doing that has been to find a way to fill the cars that leave the West Coast loaded with Asian goods for the Midwest and East Coast and return virtually empty. CN has worked with other transportation companies, agricultural operations, and the government to create the infrastructure necessary for a low-cost, efficient supply chain that reaches all the way to Asia, encouraging the export of agricultural products to China for processing. Similarly, the company worked with ethanol producers to find safe ways of transporting the combustible alcohol over rail as the export market grew. CN also benefited from the fact that transport of metallic ores almost doubled in 2005, mainly feeding China's manufacturing boom.

This market responsiveness, which CN shares to some extent with the BNSF Railway, Union Pacific, Norfolk Southern, and others, is typical of a visionary rail company, as is CN's disposal of unprofitable lines of business. Take, for example, dropping off and taking on single boxcars loaded with industrial products at small towns en route. This used to be an established part of freight rail company service. But CN has largely dropped that part of the business, focusing instead on becoming a "scheduled freight railroad" with on-time performances to not only rival, but beat, trucking over medium to longer distances. The impact is enormous, with a reduction in rolling stock possible thanks to reduced complexity in point-to-point services and higher train velocity. Similarly, CN has been a market leader in the introduction of radio-controlled locomotive switching, which reduces employee costs.

Shippers, too, have changed their business practices to reap the benefits of new, more efficient rail services. Grain producers, for example, have invested in larger silos; because the producers can load more grain at a time, the railroads can use multiple cars and longer trains for each shipment, rather than running smaller trains several times. This gives CN economies of scale that allow it to offer lower rates to shippers, as well as providing better service.

Railroads still confront issues involving a unionized workforce, outmoded work rules, and various legacy agreements and restrictions from an earlier era. But despite a small dip in rail freight tonnage figures in early 2007 and some highly publicized train derailments in ecologically sensitive areas, the North American freight rail industry's future looks bright.

Amtrak's Unexpected Triumph

Probably no passenger railroad turnaround story is as significant as that of Amtrak; it suggests that dedicated management can overcome a host of obstacles. Since it was formed in 1971 as a U.S. government–owned amalgamation of the largely declining passenger lines of private railroads throughout the United States, Amtrak has fought a losing battle for financial independence. Even in its most successful years, since 2002, Amtrak has barely survived on a federal government handout of $1 billion per year on top of fare receipts. Its funding allocations are driven largely by political considerations, rather than by Amtrak's operating and capital needs. As a result, investments in rolling stock and infrastructure have repeatedly been postponed.

Nowhere is this felt more acutely than in the Northeast Corridor, from Boston to Washington, D.C., the most densely populated area of the United States.

Nearly 50 percent of Amtrak's $1.4 billion in annual ticket revenue comes in through the Web site, instead of through the high-cost call center or station agent channels.

There, freight and commuter railway companies all use Amtrak-owned track while competing with Amtrak for business. The Northeast is the oldest section of railroad in the U.S. and has been in disrepair (some would say "patched together") for decades, due to underinvestment by a series of administrations in Washington. This has led to power outages, bridge closures, and disruptive engineering work. The rolling stock is also old, and Amtrak trains in the Northeast Corridor are often late and sometimes canceled owing to mechanical problems. Commuters in the country's Northeast are among the most frequent train riders, but their experiences have too often landed them in the dissatisfied or disgruntled camp. As a result, Amtrak has been plagued by negative public perceptions throughout most of its history.

Yet despite these adverse circumstances, Amtrak was able to launch the Acela Express, a higher-speed rail service and an immediate hit with businesspeople and politicians shuttling among the eastern seaboard's major cities. (See Exhibit 2.) The company had recognized an underserved rail passenger niche that needed a reliable, speedy, and relatively comfortable alternative to air travel. To market a new rail service to them, Amtrak studied Eurostar, made up of private companies that had broken free of their largely state-owned parents in 1994 to establish a separate and unified marketing organization known for innovative advertising, competitive leisure promotions, and a generous frequent traveler program.

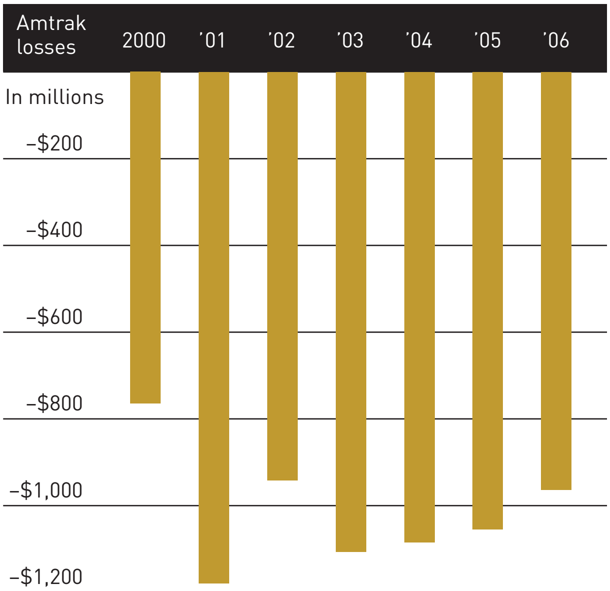
Amtrak also sought out leadership from the commercial sector and developed its existing talent with an eye toward becoming more market-facing. For instance, Amtrak's board reached outside the railroad industry to tap Alex Kummant as president and CEO in 2006. Along with his prior railroad experience, Kummant was a veteran of Invensys Controls and Komatsu America Corporation, both manufacturing companies. Significantly, he was chief marketing officer at Komatsu America.

The value of Kummant's marketing background was evident when, early in his tenure, he promoted Emmett Fremaux to vice president of marketing and product management, greatly expanding the scope of those functions within Amtrak. Fremaux had been the railroad's vice president of customer relationships and revenue from 1996 until 2001; he had spent some time at the consulting firm Accenture, then returned to Amtrak in 2005. His promotion provided an executive-level mandate to align marketing efforts with product performance improvement to drive ridership and revenue growth.

Such moves have set the stage for Amtrak to engage in a period of genuine marketing innovation, supported by technology. It now collects data and tries to understand how passengers are affected by changes in pricing or scheduling, a huge step because it allows for a strategic approach to channel-based sales distribution. Although it is not yet as sophisticated as some leading airlines, Amtrak now encourages ticketing online at www.Amtrak.com, and passengers can also buy tickets or pick up prepurchased tickets at kiosks in train stations. In fact, nearly 50 percent of Amtrak's $1.4 billion in annual ticket revenue comes in through the Web site, as compared with the high-cost call center or station agent channels. Passengers can check information about delays online, and "Julie," Amtrak's natural-language, full-service telephone-based automated booking agent, is also available to assist customers. All of these channels were developed by Fremaux during his tenure as VP of

Exhibit 2: **Decreasing Losses at Amtrak**

Amtrak's losses have been mitigated by improved management of its historically high expenses and a general upward trend in revenues, driven in part by the Acela service in the Northeast Corridor, which was launched in December 2000.



Source: Amtrak annual reports, 2001–2006; Amtrak press release FY07; BTS Rail Profile 1960–2001

customer relationships and revenue. They have been essential for Amtrak in dealing with professional, educated customers on its Northeast and California routes.

The bonus is that the new systems, while helpful to customers, also help Amtrak maximize its revenue. Booking an Acela ticket is now sophisticated in a way that the old Amtrak never was. Amtrak borrowed from the airlines' experience with analyzing load factors (the percentage of capacity that is sold) to develop a differentiating pricing strategy for the Northeast Corridor. Peak-hour trains are costlier, as are same-day round trips. This premium price competes with airfares for the same routes, taking advantage of rail travel's greater convenience to downtowns, lower susceptibility to weather-related delays, and less-restrictive security measures. Conversely, weekend excursions are priced to allow couples and families to use the trains less expensively. The challenge for Amtrak now is to apply these innovative marketing approaches to all of its business lines, taking broader advantage of the customer-focused capabilities that enabled the Acela to succeed. It can certainly be done: One success story is Amtrak's Guest Rewards program. It, too, targets the business traveler, featuring partnerships with corporate hotel chains and car rental firms as well as plentiful points earned on full-fare tickets, which can be redeemed on leisure trips or membership in frequent-traveler lounges.

Despite increased competition from low-cost airlines and the Northeast Corridor's creaky infrastructure, ridership continues to rise. This growth, which has contributed vital revenue streams to Amtrak, has begun to subtly shift public opinion on rail travel. Especially as environmental issues become more prominent, gridlock confronts more automobile users, and airports struggle with security measures and overcrowding, the appeal of high-speed rail is growing.

It's growing so much, in fact, that the U.S. Congress has proposed a new reauthorization bill for Amtrak that not only would pay $3.35 billion toward general upkeep of the infrastructure until 2011, but also would create a $5 million per year fund for more high-speed trains, dubbed the Next Generation Corridor Train Equipment Pool. If passed, these long-term investments will allow Amtrak to revamp its infrastructure and rolling stock to keep up with its advanced marketing and product management strategy.

The Growth Years

Why has it taken so long for railroads to capitalize on the advantages of growth? Essentially, these companies have needed to go through three distinct stages of development. The first was simply cost improvement, often involving shutting down rail lines, selling noncore assets, and eliminating large numbers of redundant employees. In management parlance, companies plucked the "low-hanging fruit." The second stage of change involved taking these smaller, slightly more focused organizations and gradually improving the ser-

Lessons for a Counterpart

by William J. Holstein

Postal services have run on a track similar to that of railroads in terms of privatization and their need to compete with commercial enterprises. As postal reform looms large in both the United States and Canada, decision makers will have the opportunity to put to use many of the lessons from the railroads' growth initiatives.

The U.S. Postal Service (USPS), a giant with US$68 billion in sales and 700,000 employees, has been engaged in a compete-and-cooperate pattern with two private-sector companies, FedEx and United Parcel Service (UPS). That has helped spur the USPS to make dramatic strides in quality and performance. FedEx and UPS have also played a key role in introducing new sorting and online tracking technologies that have spread into the postal system. In this sense, allowing a measure of competition in this formerly government-dominated sector has been fruitful for the agency.

Additionally, the USPS has benefited from the fact that Postmaster General John E. Potter has been open to innovative ideas from outside, which is somewhat surprising considering that he started his career as a postal clerk in New York in 1978. The result of Potter's approach has been such products and services as Click-N-Ship, automated postal centers, and prepaid Priority Mail.

But the post office is still mired in overlapping and constricting regulations. In late 2006, Potter and his allies in the corporate sector helped push through Congress a new law that put the service on firmer financial footing, preserving universal service at affordable rates, but allowing price increases tied to the rate of inflation. Potter is likely to continue to press for reforms that would allow the USPS to compete more directly with FedEx and UPS, particularly in the overnight delivery market for both letters and parcels. He says that he seeks to create a more competitive, market-facing organization. One obvious stricture that could be eased is the requirement that the USPS deliver mail to every community in the United States, no matter how remote, six days a week. Easing that to even five days a week would cut costs enormously.

The U.S. Postal Service is not the only one experiencing major changes. Some observers speculate that Canada Post will be privatized. Moya Greene, who was named president and CEO in May 2005, has experience in both the private and governmental sectors. Most significantly, she was part of the Ministry of Transportation and is credited with the privatization of Canadian National Railway. In view of the success that CN is enjoying, it would not be surprising to see Greene attempt to apply her privatization experience in her new role.

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vice they offered, mostly in small, incremental ways.

But the third stage, which most rail companies are just entering now, is growth. Whether they are governed by the public sector or privately owned, experience suggests that railroad companies (with the exception of some railroads, like New Zealand Railways, that face unique challenges in their competitive environments) must display four characteristics to achieve genuine growth.

1. Willingness to take risks. Amtrak did not wait for a market for Acela to develop. It used an arsenal of marketing tools, including passenger segmentation, loyalty programs, viral marketing, and targeted promotions, to carve out a niche in a competitive market where none previously existed. If the right management mentality is in place, even a government-sponsored railroad can innovate and succeed.

Equally, CN has not been constrained by the traditional ways of doing business in its markets. Its acquisition strategy, for example, was remarkably bold. The end result is that its freight cars roll on, but they now carry much more profitable loads and serve as a vital connection to the global marketplace.

2. Enhanced leadership capabilities. Until the 1990s, most railroad companies had been unsuccessful in attracting the new talent that all businesses need — infusions to reshape their culture and operating style. Success at CN and Amtrak is clearly linked to the arrival of new players. These senior executives from outside placed in key decision-making roles become the agents of change. That process may involve a wrenching cultural transformation because the traditional utility mind-set of setting prices and controlling routes has to give way to a greater emphasis on strategic planning and marketing.

The most visionary rail companies also recognize marketing as critical at the executive level and give marketing decision makers significant authority. Their scope of responsibility extends beyond advertising and public relations to product strategy. Marketing provides the link between functions performed across the organization: pricing, sales and distribution, product development, and customer service. A railroad chief marketing officer role requires capabilities and technology to truly understand and meet the consumers' needs.

3. A firm definition of success and the metrics to measure it. The railroad industry's culture is changing: Executives are recognizing that the point of the game is not to maximize gross revenues (especially when not all business segments can be profitable), but rather to use available information to maximize returns in every line of business. Amtrak is now capable of measuring what its customers are thinking about its services, a remarkable breakthrough in many ways. CN has learned how to measure any new initiative's impact on revenue growth and profitability.

4. Determination to become truly market-oriented. Customer-facing organization models are in many ways the opposite of the command-and-control models that prevailed in regulated industries. Achieving this kind of organizational transformation is extremely difficult, but the evidence is overwhelming that it is a key to growth. And it can happen whether a railroad is government sponsored or fully privatized.

In short, the railroad organizations that were once inward-looking are now forced to look to the market. They must innovate across all aspects of their business — including their management styles and technological systems. And they have to embrace marketing as a science for helping them understand what customers want and then giving them what they need. If railroad organizations heed these lessons, they can escape low margins and low growth rates, achieve much higher performance, and build a more sustainable and loyal customer base than anyone might have imagined previously. +

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Resources

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