ROY BLANCHARD

Manage information before you manage freight cars

A lesson from Watco and Kansas City Southern

Rick Webb, CEO of Watco, the Kansas-based shortline operator, has a system called the annual operating plan that lets him know, for every load of freight that moves on any one of his 16 short lines, exactly what it costs to handle the move — from empty received to load out. He has to know because it's the only way he can tell if he's making any money. Moreover, he has to know because the industry's move toward "market pricing" sets prices first.

The Interstate Commerce Commission used to set rates, and the railroads had to justify every increase by showing costs were rising. Competition had nothing to do with it. The Staggers Act of 1980 deregulated railroad pricing and let railroads start charging according to what the traffic will bear — market pricing in other words.

Here's how it works. Watco has a customer on its Timber Rock Railroad in east Texas who wants to ship lumber to a Home Depot warehouse in Chicago. Say that lumber sells for $200 per thousand board-feet in Texas and $250 in Chicago. The $50 spread is transportation so the market rate for transporting 80,000 board-feet of lumber from East Texas to Chicago is $4,000. It makes no difference if it's truck or rail — the market price in that lane is $4,000.

Now back to Webb and per-car cost. Timber Rock interchanges with BNSF, Kansas City Southern, and Union Pacific. His market manager approaches all three and determines the best value is KCS. Since Timber Rock is a handling line for KCS, it gets a flat fee per car, irrespective of what's in it or its destination. Let's say (as example only, as actual rates are confidential) KCS pays Timber Rock $400.

Now Webb turns to his annual operating plan where customer expectations and the consumables required to support those expectations are matched up. The elegance of this is it strips out non-operating, non-cash line items like depreciation, and it budgets the man-hours, fuel, car days, and other items consumed to support this lumber move. (Normally, 80 percent of avoidable cost goes for car hire, fuel, labor, and locomotive cost.) The operating plan says what's expected in terms of cash. If Timber Rock can make the move for $285 it gives them a revenue-cost ratio of 1.4 to 1, not unreasonable in today's railroad environment. So $400 provides a nice margin.

This is a particularly elegant way for dealing with items like car hire. Since asset turns are key to managing capacity, car days per revenue move tells a predictive, non-cash story linked to specific customers rather than a historical cash line-item story that's hard to link to any specific customer requirement.

Meanwhile, KCS runs the same numbers. And whereas some Class Is still use "legacy" costing that dumps every move into one

costing bucket, KCS, like UP and Canadian National, have devised a means for determining the actual avoidable cost of every revenue move regardless of routing or car type. This management control system, a product from the Eyeris suite of business intelligence software, allows KCS marketing and operating teams to select the optimum route and car type that will give the best return on the $3,600 they will get for the move after paying Watco.

Said Art Shoener, KCS' president and chief operating officer, "The ability to track every expense related to every carload commodity pair, when combined with the power of our management control system, has helped us reduce per-unit costs and add value to

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To put matters in perspective, this management control system, in a matter of months following its debut five years ago, let KCS increase train speeds by 9 percent on average, cut terminal dwell times by 10 percent, and reduce cars on line by 3 percent. It also let KCS take 11 percent out of unit coal train cycle times, and run the whole railroad with 5 percent fewer crew starts.

This is putting a lot of pressure — financially and operationally — on 150 miles of UP trackage rights between Rosenburg and Vic-

toria, Texas, via Flatonia. KCS owns the former Southern Pacific between the end points and in late 2006 began the process of reconnecting the dots. The end-game here is a 90-mile straight shot of new 136 lb. continuous welded rail dispatched by KCS. Of course, to make the case for the capital commitment to rebuild Rosenburg to Victoria, KCS had to know what it was spending over the UP and what it would likely spend over its own route.

Railroads create huge amounts of data, from car movement (interchange in, placement, pull, interchange out) to operating reports (trailing tons per h.p. per train start) to safety stats (injuries per 200,000 hours worked) that must be collected and studied.

While it's true that the railroads were among the first industries to computerize to support complex order fulfillment, traffic classification, and train control processes, it was all done to manage events. Using the data thus gathered to drive the business was never a consideration. The guy who said, "I'd have a great railroad were it not for all these damn customers" summed up the attitude pretty well.

Fast forward 20 years and as Watco and KCS have shown, the need to use that warehouse of data to run the railroad precisely to meet customer requirements and to shape operating activity accordingly has become painfully evident.

Whether it's the annual operating plan or the management control system, short lines and Class Is have a vested interest in managing information first, moving cars second. ⊥

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