



“From PSR to Chicken: It’s all about culture”

by

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Thank you for the introduction. Let me set your expectations appropriately—I hope to talk for about 20 minutes and then I hope we will have time for a dialogue vs. Q&A. A topic like Precision Scheduled Railroading invites a conversation!

First and foremost, a couple of items of context. The Iowa Interstate connects with every Class 1 railroad, so let me start off by saying that I agree with everything that everyone from every Class 1 railroad has ever said or thought in his/her life. Second, in addition to teaching at Carnegie Mellon, one of the greatest compliments that I was paid was from Laura McNichol of Watco, who said, “I was a student of railroading.” Yes, I am someone who teaches about railroading and, by the way, the name of the course is, “The American Railroad— Decline and Renaissance in the Age of Deregulation.” The most interesting thing that the students, who for the most part are not engineers, find about railroading is.....pricing. Can you imagine normal college students being interested in railroad pricing? There is hope for our industry. In fact, tomorrow morning I will be in Fargo visiting one of my former students who is now a trainmaster for BNSF. The greatest success of my teaching the course is that one of my students went into the industry, which is why I do it.

The overall theme is that the Iowa Interstate and Henry Posner will always **do what is best for the industry**. We’re a network industry and if the Class 1s are not doing well, the Short Lines are not doing well; we’re a chain so we’ll always do what is best for the industry before we do what is best for ourselves. And I hope that you will see me modeling that behavior in everything that I do.

So let’s start with **good news/bad news**. The bad news is that everything we thought we knew is wrong. The good news is that Hunter Harrison knew the way and was the Greatest Railroader Ever. The bad news is that Hunter Harrison is dead. The good news is that people who worked for him know exactly what he would have done, whatever that means, through PSR. So here is a combination of good news/bad news:

1. Many of these people are now running the industry;
2. Railroads that don’t hire them will be taken over and their management teams replaced; and
3. PSR will be universal; we all will be living in the Era of PSR.

So what’s wrong with this story? First of all, how many people here have seen the movie, “Glengarry Glen Ross”? Recall Alec Baldwin’s monologue when he walks into the sales pit and tells them that he is on a

mission from God, and **1st prize is a Cadillac, 2nd prize is a set of steak knives, and 3rd prize is that you're fired?** Well, it sometimes seems like that when talking about Precision Scheduled Railroading.

Another thing wrong with this story—Hunter Harrison was *not* the Greatest Railroader ever, **Bill Brosnan** was. How many have heard of Bill Brosnan?

OK, no one here. That is completely understandable because he has been written out of the history books. That is one of the reasons I teach a history course at Carnegie Mellon to try to change that.

The third thing that is wrong with this story is that for PSR railroads that are in transition, as opposed to PSR railroads that are post-implementation, it seems that **growth has stalled**, which is what we are seeing at CSX, and the CN people talk very freely about how they had to break things and put them back together before they were able to grow. Again, I realize that I'm an outsider who is trying to not necessarily tell you how to connect the dots but tell you what the dots are.

Another thing wrong with the story is that at the industry level, **everything we thought we knew is wrong**; and as a country we are **losing faith in our own institutions**, ranging from the government to the capitalist system; there is an increasing pessimism at the national level. This translates for example to stalled traffic growth for railroads because in a pessimistic economy, people are not necessarily going to invest and grow. That's at the level of the country and the industry, as opposed to individual private companies (and the last time I checked, BNSF is still a private company).

People don't talk about growth; **the operating ratio is the single biggest topic**. But the problem with that is that it is only one of several measures that drives the value of companies. It's a short-term measure, and more to the point, I believe that it is easier to cut costs than to grow the business. It is easier to raise rates than it is to grow the business. So as the operating ratio is the ratio of costs to revenue, if you cut your costs, or increase your revenue through rate increases, of course you'll look better....in the short-run.

The second set of missing elements is some brand new themes which I do not recall being discussed at any industry event until a recent Class 1 conference, and this was mentioned to his credit by Chuck Baker, the new ASLRRRA President, which is the word **resiliency**. In an era of climate change, people are probably starting to think about this, but it certainly has not made its way to any Wall Street analysis, and that is "What about the cost to the industry of climate change...impact on our customers...impact on our infrastructure?" How do you put a price on that? And if you can't put a price on that, it's not necessarily going to creep into the type of dialogue that a Wall Street analyst can give you on the value of companies.

And the other missing piece is **populist backlash**. The current political environment seems to be pro-business but that can turn on you very quickly, as some companies have already found out. To the extent

that there are conversations for example at the Surface Transportation Board that imply that perhaps the railroads are too profitable, and that it must mean that we are doing something unethical or illegal, we should take note of that. This was in fact our experience in Estonia where our Russian customers found it easier to bribe the government once they joined the EU and enjoyed an extra layer of regulation, than to pay their freight bills. So don't think the rule of law is necessarily going to work because remember—regulation is about laws.

The success of our industry has been independence from economic regulation and our independence from public funding. The genius of **deregulation** was our independence from the government at all levels – deregulated prices. “You people are an obsolete, dying industry; there is no money for you; solve your problems; but the good news is we will allow you to go out of business or whatever it takes.” That is why we are here today. By the way, that is one of the major themes of my course at Carnegie Mellon.

These are words of caution. Let me say once again, **Wall Street has not figured out a way to price the impact** of resiliency on a stock price nor is there anything I believe on the impact of a stock price from a populist backlash, which I think is more likely to work against us than for us.

Next let's look at the possible interpretations of what's happened in this new era of PSR, where we are looking at the tea leaves of a dead person, to try to figure out how to manage our industry. First of all, I think the experience of PSR does in fact say something, and that is, **in many cases our industry does need dictators**. If you look at what Bill Brosnan did at the Southern, and in my opinion he was the Greatest Railroader Ever, not Hunter Harrison. He was a dictator; he was not a very nice person, which is why only 2 people in this room have ever heard of him. He was written out of the history books because no one liked him. He did not even make it into the book [The Men Who Loved Trains](#), which I think is the best all-time book ever, but for a footnote which I believe is a reference to him throwing a desk at somebody; that was it. This was a guy who got permission for railroads to lower their rates; who automated track machinery; who invented distributed power; and a long list of other things that came from one individual who by force of will made things happen, and nobody has ever heard of him.... because he was not a nice person.

Would PSR have worked for a company like CSX unless there were dictators? Probably not. CSX was a layer upon layer of unconsummated mergers, where you had mergers of equals upon mergers of equals and the end result was a company that did not have a culture. Well, they have a culture now, and I think that is a great contribution that Hunter Harrison made to CSX. Conversely, **implementation of major cultural changes** to a company like Canadian National was made possible in part because it was a single culture, and more to the point, Canadian culture is more subservient than American culture. It is a Commonwealth legacy and Canadians are more likely to accept direction from above than Americans.

The interesting question is, how is this going to work at Union Pacific and Norfolk Southern, which I would argue have two of the strongest, proudest cultures in the industry, and how do they say that everything they thought was right, is wrong? That will be interesting, and that's why it is **important to be a student of the industry** and watch what happens in those companies. One thing that I can predict is that there will be a time lag if it doesn't work and when we hear about it, because no one will be motivated to say so. That being said, I haven't heard of any problems at either company.

At this point, most of you are tired of hearing the term PSR but I'm guessing that most of you have not heard it defined in a single sentence. So let me try defining it as **"a manageable number of shared objectives which every employee knows and has ownership of"**. Please note that it is not about closing yards and running coal and intermodal on the same train or all the other stuff that railroads are doing. It's got nothing to do with that. I would argue that closing yards, combining trains, etc. is the result of focusing on a limited number of objectives and that they are the product of PSR, not the method of PSR. One problem is that there is enough wiggle room that anyone can say that it is a PSR expert, and if you don't hire me, then Wall Street will fire you, and I'll be your boss anyway.

So let's look at the long-term perspective and what the industry implications are, and I'm not going to say good news/bad news, but rather let me express some concerns as well as some good news.

My concerns are: what if PSR has **Unintended Consequences**, and what if the entire industry has built itself around something which has some flaws that no one has really thought about yet? The good news is that, at least in the short run, there are efficiencies that have been generated; it is not clear what the customers think but from a cost perspective it is clear that PSR railroads are enjoying lower costs. Another concern is **monoculture**. If there is a single culture in the industry, is that healthy or not? What we used to enjoy was a rivalry between Norfolk Southern and CSX, who did things in radically different ways; and the Union Pacific and BNSF, who do things in radically different ways. Fortunately, BNSF is still a private company so somewhat immune for now.

And a third concern is the **personal commitment to the industry** and the level of lifetime commitment from the people at the top. Here are some extreme examples: Robert Young was the Chairman of the New York Central and committed suicide when his hostile takeover didn't work. That's commitment! At the time, the New York Central was less than 10% of the industry.

A different example was Shinji Sogo who led the bullet train project in Japan; the way he would have an argument is: "okay, if you win, you commit suicide, if I lose, I commit suicide." So, he was able to provoke important discussions with a level of commitment that quite often the people sitting on the other side of the table were not able to make. People with a short-term investment view and the people espousing things may not be around in the next 3-4 years; they may move on into another industry; and **we are an industry that must manage for the long-term**. And to our credit, I think we do. The good news is that the

people in the short line industry are long-term managers with personal stakes in the business. Minnesota is blessed with family-owned, privately-owned short lines. I'm not sure if you have the highest ratio of privately-owned short lines in this country, but certainly Minnesota's short line portfolio is both diverse and closely-held, which I think is extremely important.

The other advantage that we have as Americans, or should I say American railroaders, is that we're not culturally European. Europeans are afraid of failure; they have a culture of hopelessness; and because no matter what you do, it ultimately gets back to government ownership. If you're a private company running on the main line, it's still a government main line. We don't have that, so we are **still for these reasons the world's best** at what we do; and I don't see a lot of argument in the global marketplace that the USA is anything less than the world's best.

The best evidence of this is if you look at how railways are privatized around the world. In Latin America there are only two railways that are still owned by the government – Venezuela, which has not run for a couple of years; and Cuba. Otherwise all the other railways in Latin America are privatized. All of them were privatized more or less along the same lines, which is private companies leasing the assets from the government, kind of like a Norfolk Southern Thoroughbred lease. If you look at many Latin American privatization models, that was Conrail. Libby Ogard and I are both Conrail veterans and have been through it; it is a matter of great pride that **the Conrail model has had so much influence around the world**.

The good news is what I've just said about the future of our industry, and that there is **still a possibility in this country for surprises to come around the corner**. Yes, a generation ago there was a surprise that the marketplace would support a fourth main line from Chicago to Omaha; that is the Iowa Interstate. But more recently, "everybody knows that you can't make money on passenger service", right? Well, Brightline, aka Virgin Trains, may be changing that view. And finally, in Europe "everybody knows that single car freight service is doomed", but we are doing something about that with a company called RegioRail. If you drink a bottle of Evian water in this country, it came on one of our trains.

Let's go back to the title, ***it's all about culture***. Here are a couple of cultural comments. For the Southern it was Bill Brosnan's ability to single handedly, through force of will, create a culture; and that book is probably the worst rail biography ever written, The Railroads' Messiah. It's 1,200 pages; I started reading it in February; I finished it last week. It is a slog; it is so bad that the Lexington Group in 1997 wrote a scathing review that this is the worst biography ever written, which is why I bought a copy; but it sat on my shelf until I was invited to Brosnan Forest for the first time. The book is so bad that it was privately published. But if you look on the web, copies of the book are going for the same price as some of the Hunter Harrison books. Check your used-books websites today for the book, Brosnan, The Railroads' Messiah against one of the Hunter Harrison books, and see who has more stock. They're both dead; they were both dictators; and they both had influence on the industry. There is a book Confederates in the

Attic that is about how the Civil War never ended, and I think that is an accurate description of what CSX was like before Hunter Harrison arrived.

Our own experience, and this where we'll talk about *chicken*, is **all about culture but it depends on what culture you're in**. In Guatemala, the way we went for a year and a half with no injuries, in a country that is not exactly known for its safety culture, was the following: when we went 6 months with no injuries, everyone in the company got a chicken dinner for a family of five. In the final weeks of operation when it was clear that the government was never going to allow us to survive, our only course was to shut down and take them on in the international arbitration environment; and we won, by the way. But really we lost; everyone lost. A friend of mine was documenting the last weeks of operation with video and off-camera you could hear someone who was working on a derailment say, "Work safely! Don't mess up my chicken dinner." So in our own way we had created a culture of ownership among our people where by emphasizing safety, we were able to go 1-1/2 years with no injuries, even in the final weeks of a doomed railroad.

In the case of Estonia, we were one of the shareholders in Estonian Railways, the only former Soviet railway to be privatized. When Estonia joined the EU, it became more corrupt, because more regulation coupled with the value of the traffic, meant there was more to be achieved through corruption. The **Board focus was on safety**; and this is what we do on the Iowa Interstate. What we instituted on Estonian Railways was that when there was a reportable injury of any kind, the Board got an email. And management learned very quickly that that it was important to the owners, and that's how we reduced the injuries by 75% in the 5-1/2 years that we were there.

More troubling is a recent Class 1 conference, where in conjunction with PSR, the company talked about they were **no longer a safety company but a transportation company**, which I found shocking as well as other people in the audience. Also, they were no longer going to be the nicest company in the industry; imagine saying that to 300 people!

The good thing about PSR, and this is the cultural part, is that **PSR is about a culture of ownership** because if you are in fact empowered and motivated to achieve a limited number of management goals, then you are expected to buy in and you are expected to contribute to the achievement of those goals. That's why you see yards closing and coals trains on the back of intermodal trains, etc.

Let me conclude by saying that the book **The Men Who Loved Trains** (sorry, there were no women—this was the 1970s) is the single best book as to how the industry got to where it is today. But you will not read about Bill Brosnan in that book and therefore you also need to slog through the book, **The Railroad Messiah**, if to be fair, you also spent the \$300 to get your own copy of one of the Hunter Harrison books so you get to keep your job at your Class 1 railroad. The book, **Confederates in the Attic**, I would argue is representative of CSX's culture before PSR; it's a fun read and you'll probably read something about your

favorite railroad no matter which Class 1 railroad you work for because every Class 1 is a result of mergers, some successful, some less successful.

Earlier I talked about commitment to the point that people committed suicide if they did not achieve their objectives. In the book **Robert Young, the Populist of Wall Street** we can read about the hostile takeover of the New York Central and how it didn't work and how Robert Young blew his brains out. And **Old Man Thunder**, the story about Shinji Sogo, who basically lied in order to get the bullet train built; gave a bunch of false assumptions; and threatened to commit suicide and challenged others to commit suicide based on stuff he made up. But he in fact underestimated by many orders of magnitude how well the bullet train was going to work.

To conclude, probably everyone in this audience is concerned about the long-term perspective of the industry. There are concerns – what if PSR is wrong; is the industry becoming a monoculture; where is the personal commitment? But there is an equal amount of good news — the diversity of the short line industry, a model for the world; the uniquely non-European approach of our industry, which is **we are not afraid to fail; we do have a culture of ownership; we don't have a culture of hopelessness**, etc.

I hope by this discussion I have made you reasonably comfortable with the idea that **it's all about culture**; we talked about safety culture in our industry; and maybe now we're talking about ownership culture, and other aspects of culture. I'm not sure where resiliency fits in, but it is probably a culture of public service because if we're not serving the public, then we're not doing our jobs.

I appreciate the opportunity to speak because I'm not sure that I'm right. Let's go back to the part where I'm a student; I hope to learn something from people who disagree with me.

Thank you very much.

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