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WISCONSIN CENTRAL 1994: CONTINUING SUCCESS IN THE RAILROAD INDUSTRY

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WISCONSIN CENTRAL 1994: CONTINUING SUCCESS IN THE RAILROAD INDUSTRY

Abstract

Approximately 25 years ago a majority of the railroads in the industry were either in or near bankruptcy. As a partial cure, a series of federal and state legislation was enacted which freed the industry from archaic laws passed in the days railroads enjoyed a virtual monopoly in U.S. transportation. One of the outcomes of this new legislation was the freedom granted major railroads to abandon or to sell off excess trackage to entrepreneurs. The Wisconsin Central (WC) is a regional railroad that was spun off from the Soo Line Railroad in 1987 and purchased by a group of entrepreneurs. The case traces the WC's last three years of operations which have seen steadily increasing business, revenues and net income. Operating in a hostile environment, the WC has succeeded as a result of innovative management, marketing, operating and HRM practices. Utilizing a mix of market penetration and horizontal integration, the railroad is in some danger of being the victim of its own success. Mushrooming traffic seems to stay ahead of the WC's capacity to handle it. Increasing customer dissatisfaction coupled with employee complaints of 10 and 11 hour days does not bode well for the company. Is it time for the WC to pause until it gets its house in order?
WISCONSIN CENTRAL 1994: CONTINUING SUCCESS
IN THE RAILROAD INDUSTRY

President Ed Burkhardt glanced again at the favorable article in the *Milwaukee Sentinel* concerning the July 28, 1994 announcement that the Wisconsin Central Transportation Corporation (WCTC) had agreed to purchase the Algoma Central Corporation’s railway.1 This action would add 320 miles of track running north between Sault Ste. Marie and Hearst, Ontario. The agreement also included 966 rail cars and 23 locomotives. More importantly, it would enhance the U.S.-Canada movement of iron ore, paper and wood pulp plus provide connections to the main lines of the Canadian National (CN), Canadian Pacific (CP) and Ontario Northland (ONT) railways.

Ed had led the WCTC since start up in 1987 and was pleased with its progress. Traffic had grown year after year, mushrooming in late 1993 and 1994 to date. Resultant revenues had continued to climb, net income improved, and debt to equity reduced. Yet, not all was well, the company was in some danger of being a victim of its own success. With the influx of business came the continual need for more track, more railcars, more locomotives, more trains, and more people. A Herculean effort by all seemed to leave the company, on occasion, a quarter step behind demand. A few customers had begun to complain about service and operating employees about long hours. Was it time for WCTC to pause in its expansion efforts? Would potential on-line customers and attractive investment opportunities wait? Life was never dull in the railroad business, Ed thought.

**Industry Background**

In the 160-year history of railroading in the United States, the industry has traveled through some of its most profound changes during the past two decades. The combination of deregulation in the transportation arena, basic changes in the nature and output of American heavy industry, the loss of local business, and the dramatic increase in long-distance coal movement for power generation have caused the railroads of today to be far different from the traditional railroads of yes-

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This case is intended for classroom discussion only, not to depict effective or ineffective handling of administrative situations. All rights reserved to the authors and the Southwest Case Research Association.
Railroads were once responsible for hauling almost everything and everyone into and out of every city and village. For example, in 1929 they accounted for 75 percent of all United States intercity freight ton-miles. The volume of freight handled by today's railroads is more than double that of 1929, although the railroad industry's share of freight has been greatly reduced by trucks, river carriers, and pipelines. In 1993 railroads handled 37 percent of all freight ton-miles. Thus, railroads have evolved from general freight haulers to specialized freight carriers primarily handling large volume bulk commodities and oversized loads. In addition, intermodal traffic -- which is the movement of containers and truck trailers on rail cars -- has enabled railroads to recapture general products and merchandise formerly lost to the trucking industry. In 1994 United States freight railroads are regarded as being more profitable and efficient, and in better physical condition than at any other time in recent history.

The Association of American Railroads (AAR), the principal industry organization for the freight railroad industry, classifies all of the common carrier railroads operating within the United States into one of three categories based primarily on annual operating revenue. The first category includes the major rail freight carriers which are defined as Class I railroads and must meet an adjustable revenue threshold, which in 1992 was $251.4 million. The next category includes regional railroads which are those carriers that operate at least 350 miles of track and/or earn revenue between $40 million and the Class I threshold. The WCTC's Wisconsin Central (WC) subsidiaries are classified as a regional railroad, the largest of 33 such mid-sized carriers in the United States. Most regional railroads were formed during the 1980's from systems of secondary and branch lines no longer wanted by larger Class I railroads. The third category includes local -- or "short line" -- railroads which are all those that fall below the regional railroad criteria and include Switching and Terminal railroads. A comparison of these three types of railroads is shown in Table 1.
### Table 1: Types of Railroads in the United States: 1992 (millions)

<table>
<thead>
<tr>
<th>Type of Railroad</th>
<th>Number</th>
<th>Miles Operated</th>
<th>Employees</th>
<th>Annual Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Class I</td>
<td>12</td>
<td>126,237</td>
<td>194,120</td>
<td>$27,508</td>
</tr>
<tr>
<td>Regional</td>
<td>33</td>
<td>20,697</td>
<td>11,600</td>
<td>1,514</td>
</tr>
<tr>
<td>Local</td>
<td>464</td>
<td>22,730</td>
<td>12,885</td>
<td>1,242</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>509</td>
<td>169,664</td>
<td>218,605</td>
<td><strong>$30,264</strong></td>
</tr>
</tbody>
</table>


### Beginnings

During the 1970s and into the 1980s, the railroad industry in the upper Midwest had felt drastic changes stemming from the deregulation of both trucking and railroads, the decline of heavy industry, the loss of local railroad business, the growth of coal traffic, and mergers. During this period, many lines merged, were downsized, or disappeared with pieces purchased by former competitors or, in many cases, entrepreneurs desiring to operate their own railroad.

It was during this time that the Soo Line Railroad Company (Soo), a long-established conservative railroad serving a seven-state area of the Upper Midwest, decided that its fiscal viability would be best assured by selling off much of its network throughout Wisconsin and the Upper Peninsula of Michigan. The successful bidders for this trackage which became the Wisconsin Central were a five man entrepreneurial team headed by Ed Burkhardt and Tom Power, both seasoned railroad executives. The sale price of $122 million was largely debt financed and purchased 2,134 miles of track or trackage rights plus associated buildings and adjoining property.5

The new regional railroad was not bound by Soo union labor agreements and was therefore not required to have a union work force. Beginning salaries were pegged anywhere between 28 and 33 percent below comparable jobs on unionized railroads but were well above the average Wisconsin wage earners income. Work rules were designed to permit far more flexibility than was the case on the Soo Line.6
Success to Date

In its first seven years of operation, Wisconsin Central qualifies as a success by just about all measures. From 1988, the first full year of operation, through 1993, annual operating revenue had increased from $94 million to $152 million and net income from $3 million to $15 million. Annual revenue carloads increased from 145,000 in 1988 to 257,000 in 1993. Between start-up in October, 1987 and July, 1994, the number of employees rose from about 660 to 1,370; regularly scheduled daily trains increased from 36 to 86; the number of locomotives from 98 to 179; freight cars from 2,900 to 10,200. An initial stock offering in 1991 and a follow up in 1992 were favorably received in the market place and, along with debt, were used to fund large equipment and physical plant improvements.

The Wisconsin Central has earned an excellent reputation in what is generally regarded as a conservative industry as well as from customers. In recognition of the Company's excellent service, trade publications such as Distribution and Railway Age, and major customers such as Consolidated Papers and 3M have presented awards to the Wisconsin Central. The railroad has also been the focus of many news items and stories in both the general and industry media. Wisconsin Central has become a textbook example of a successful leveraged buy out.7

Description of the Company

Corporate Structure

The corporation is organized as a holding company, Wisconsin Central Transportation Corporation (WCTC) doing business through five wholly owned and consolidated subsidiaries. These include: Wisconsin Central Ltd. (WCL), which carries out all U.S. railroad operations and is the largest and most prominent subsidiary of the corporation; Fox Valley & Western, Ltd. (FV&W), formed basically for financing purposes in order to purchase other regional railroads in Wisconsin and is indistinguishable from WCL; WCL Railcars, Inc. (Railcars), which owns locomotives and freight cars and leases them to the railroad; Sault Ste. Marie Bridge Company (Bridge), which owns the international rail bridge connecting Michigan with Ontario; and
Wisconsin Central International, Inc., which enables the company to invest in railroad ventures outside the United States. For purposes of clarity and simplicity, WCL-FVW, Railcars, and Bridges are collectively called Wisconsin Central or WC in this case.

Mission

Wisconsin Central's mission is summarized by its pledge that liberally appears in company marketing and other materials: "to offer superior transportation consisting of more frequent, dependable train service, at competitive prices, with proper equipment, accomplished by customer-minded employees."

Routes and Hubs

The WC owns or operates 2,507 route miles of track and trackage rights in Wisconsin, the Upper Peninsula of Michigan, eastern Minnesota, northeastern Illinois, and Sault Ste. Marie, Ontario. Main lines extend from Chicago, through Fond du Lac, to Stevens Point, and then on to Duluth-Superior at the head of Lake Superior, and to Minneapolis-St. Paul as shown on Map 1. A main line also extends from Neenah-Menasha north to Gladstone and Sault Ste. Marie. The majority of the main line permits freight train speeds of 40 to 50 m.p.h. which is comparable with many Class I railroads, and better than most regional railroads. The main line between Chicago and Owen is equipped with a Centralized Traffic Control (C.T.C.) system which enables sidings, junctions, and signals to be controlled by dispatchers in Stevens Point. A system of secondary and branch lines are located throughout eastern, central, and northern Wisconsin, and northern Michigan. Most of these permit freight train speeds of 25 m.p.h. to 35 m.p.h., typical of such lines on all sizes of railroads.8

Freight cars are sorted and blocked at four major hubs—the classification yards at Fond du Lac, Stevens Point, Neenah, and Gladstone. Principal gateways are at Chicago, Minneapolis-St. Paul, Duluth-Superior, and Sault Ste. Marie where direct interchange is made with all major connecting rail carriers. Access to its interchanges with other railroads at Chicago and Minneapolis-St. Paul is via trackage rights on other railroads. The company owns and operates car
and locomotive repair shops at Fond du Lac, Stevens Point, and Gladstone for its own equipment and offers repair service to other railroads and clients.\textsuperscript{9}

**Traffic**

At the end of 1993, about 60 percent of the railroad’s traffic was paper industry related, as it has been since start-up in 1987. Much of the traffic consists of inbound raw and partially processed materials and supplies destined for the numerous on-line pulp and paper mills. A variety of commodities make up paper industry carloadings. Inbound shipments to the mills include pulpwood logs, wood chips, wood pulp, clay, chemicals, coal, machinery, and waste paper. Outbound shipments include wood pulp, light and heavy papers, paperboard, boxboard, corrugated stock, and some byproducts such as lignin. The 25 largest customers accounted for about 64 percent of the volume and about 71 percent of gross revenues in 1993. Of the ten shippers that accounted for over 50 percent of the railroad’s gross revenues in both 1992 and 1993, six were paper and pulp mills. The paper producers located in Wisconsin and Upper Michigan are diverse, producing many types of paper products, including magazine stock, writing papers, packaging papers, and sanitary products.

The remaining traffic represents various markets that are typical sources of carloadings on most United States freight railroads. The railroad had made a habit of tracking these markets for additional business, since they are likely to shift from time to time depending on the demand and price for raw materials and products worldwide. Other commodities transported include: chemical and petroleum products; sand, stone, and minerals including iron ore; clay products and granules; general merchandise hauled in truck trailers and shipping containers (referred to as intermodal traffic).

Intermodal traffic represents a significant portion of WC’s traffic, handling truck-competitive and time-sensitive commodities. This business represented about 12 percent of the railroad’s volume in 1993. Major intermodal loading facilities are located in Green Bay, Neenah, and Stevens Point. All have been improved recently. In 1994, the railroad also began loading containers in Arcadia, Wisconsin. In 1992, WC commenced joint intermodal services with J. B.
Hunt and Schneider International, the two largest truck load motor carriers in the country to offer shippers door-to-door truck/rail service to and from northeastern Wisconsin.

Equipment

At the end of June 1994, the railroad’s fleet of rolling stock included 179 diesel-electric locomotives, and approximately 10,200 freight cars for revenue service. The locomotives and a majority of the cars were acquired through the used equipment market, a typical procedure for newly formed railroads. Since start-up, WC has continued to acquire additional locomotives and new or reconditioned cars either through purchase or lease to meet traffic demands and to upgrade the fleet. The company has placed a heavy emphasis on reconditioning and maintenance. For example, the most recently acquired set of mainline freight locomotives are being upgraded and equipped with wheel-slip control equipment to improve tractive effort.

Management

Table 2 sets forth information about each person who serves as one of the Company’s executive officers.

<table>
<thead>
<tr>
<th>NAME</th>
<th>Age as of 5/1/94</th>
<th>TITLE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Edward A. Burkhardt</td>
<td>55</td>
<td>President and Chief Executive Officer</td>
</tr>
<tr>
<td>Thomas F. Power, Jr.</td>
<td>53</td>
<td>Executive Vice President and Chief Financial Officer</td>
</tr>
<tr>
<td>Walter C. Kelly</td>
<td>50</td>
<td>Vice President, Finance</td>
</tr>
<tr>
<td>Glenn J. Kerbs</td>
<td>53</td>
<td>Vice President, Engineering, WCL and FV&amp;W</td>
</tr>
<tr>
<td>William R. Schauer</td>
<td>49</td>
<td>Vice President, Marketing, WCL and FV&amp;W</td>
</tr>
<tr>
<td>J. E. Terbell</td>
<td>41</td>
<td>Vice President and General Manager, WCL and FV&amp;W</td>
</tr>
<tr>
<td>Robert F. Nadrowski</td>
<td>47</td>
<td>Vice President, Mechanical, WCL and FV&amp;W</td>
</tr>
<tr>
<td>Susan H. Norton</td>
<td>41</td>
<td>Treasurer</td>
</tr>
</tbody>
</table>

Burkhardt has served as a director, President and Chief Executive Officer of WCTC and its subsidiaries since its formation in 1987. From 1967 to 1987, Burkhardt was employed by Chicago & North Western Railroad (CNW), most recently as Vice President, Transportation. Burkhardt has 33 years of railroad management experience.

Power has served as a director, Executive Vice President and Chief Financial Officer of WCTC and its subsidiaries since its formation in 1987. Power was employed by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, most recently as Chief Financial Officer. Power has over 26 years of railroad management experience.

Kelly has served as Vice President, Finance, of WCTC since September, 1988. Prior to joining the Company, Kelly served as Corporate Controller for Speigel, Inc. (a catalog retailer) from 1987 to 1988, as an independent consultant during 1986, and as Vice President, Finance for Wilton Enterprises, Inc. (a distributor of housewares) during 1985.

Kerbs has served as Vice President, Engineering, of WCL and FV&W since their respective start-ups. From 1974 until 1987, Kerbs was employed by CNW, most recently as Director of Maintenance Operations.

Schauer has served as Vice President, Marketing, of WCL since October 1988 and FV&W since its inception. From 1986 until 1987, Schauer was employed by CNW as General Marketing Manager.

Terbell has been employed as Vice President and General Manager of WCL and FV&W since November 1993. Prior to that time, Terbell served as WCL’s Eastern Division Transportation Manager since the Original Acquisition. From 1973 until 1987, Terbell was employed by CNW, most recently as Assistant Division Manager - Engineering.

Nadrowski has been employed as Vice President, Mechanical, of WCL and FV&W since their respective start-ups. From 1966 to 1985, Nadrowski was employed by the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, most recently as Assistant Vice President and Chief Mechanical Officer.
Norton has been employed as Treasurer of WCTC and its subsidiaries since October 1993. From the Original Acquisition through October 1993, Norton served as Assistant Treasurer of the Company. From 1978 until 1986, Norton held various positions with the Chicago, Milwaukee, St. Paul and Pacific Railroad Company, most recently as Manager, Strategic Planning.

From the Original Acquisition through October 1993, John L. Bradshaw served as Vice President and General Manager of WCL and FV&W and Ronald G. Russ served as the Company's Treasurer. Bradshaw and Russ are currently employed by New Zealand Rail (NZ Rail) pursuant to a management services agreement between the Company and NZ Rail.

The executive officers of the Company are elected annually by and serve at the discretion of the Company's Board of Directors.

**Ownership of Stock**

The principal owners of the company's common stock are as listed in Table 3.

<table>
<thead>
<tr>
<th>Name</th>
<th>Shares Beneficially Owned</th>
<th>Percent of Outstanding Shares</th>
</tr>
</thead>
<tbody>
<tr>
<td>Janus Capital Corporation</td>
<td>840,575</td>
<td>10.2</td>
</tr>
<tr>
<td>Jennison Associates Capital Corp.</td>
<td>670,500</td>
<td>8.1</td>
</tr>
<tr>
<td>Kemper Financial Services, Inc.</td>
<td>669,700</td>
<td>8.1</td>
</tr>
<tr>
<td>Fidelity Management &amp; Research Company</td>
<td>587,300</td>
<td>7.1</td>
</tr>
<tr>
<td>Edward A. Burkhardt</td>
<td>583,956</td>
<td>7.1</td>
</tr>
<tr>
<td>Strong/Corneliuson Capital Management, Inc.</td>
<td>473,800</td>
<td>5.7</td>
</tr>
<tr>
<td>Thomas F. Power, Jr.</td>
<td>164,403</td>
<td>2.0</td>
</tr>
<tr>
<td>Robert H. Wheeler</td>
<td>100,000</td>
<td>1.2</td>
</tr>
<tr>
<td>Directors and executive officers as a group (13 persons)</td>
<td>1,415,267</td>
<td>17.1</td>
</tr>
</tbody>
</table>

**Source:** Wisconsin Central Transportation Corporation, 1994, Annual Report, p. 9.

**Corporate Strategy**

**Overall Philosophy**

The goal of WC since inception has been to maximize returns to shareholders by: increasing carloads and revenues; improving freight car utilization and transit times; upgrading
fixed plant, facilities, and equipment; paying off debt; increasing contributions to employee profit sharing; and earning a good return on investment. To achieve these goals, WC aims to do what a railroad does best: moving carloads fast and in a way that best suits the customers' needs. The officers have continued a commitment to providing rail freight service and not diversifying into non-rail areas. The company's overall philosophy is to continue strengthening its position as a rail freight carrier in the upper Midwest by making its existing system more efficient and better serving its present territory. It continues to concentrate on this approach by: strengthening its system of railroad lines; taking a proactive approach to marketing; by making physical plant improvements; by working with state and local government units and public agencies; and by becoming involved with other railroad-related investment opportunities.

**Strengthening the System**

WC's approach to strengthening its system is based, in part, on recent studies that have indicated the railroad mode share of Wisconsin's freight traffic to be about 10 percent compared to the truck mode share of between 70 and 80 percent. Thus, its competition is primarily not other railroads, but trucks. Accordingly, the railroad has embarked on a program of acquiring other lines in the area and combining them with the existing system to allow for more efficient train operation, eliminate duplicative facilities, and enable much faster - and thus more competitive - single carrier service to major gateways such as Chicago.

One of the two most important system expansions was the Superior Line acquisitions. In December 1991, a 102-mile railroad line extending from Ladysmith to Superior was purchased from the Soo. Prior to this acquisition, WC operated over this line under an agreement that prohibited the handling of overhead traffic. Overhead traffic is through traffic received from one railroad and delivered to another. Ownership of this line allows the WC to compete for all types of traffic in the Duluth-Superior to Chicago corridor. In July 1992, a 98-mile line extending from Cameron to Superior, which runs generally parallel to the former Soo Line route, was purchased from the Chicago and North Western (CNW) Transportation Company. The best portions of each
line have been combined and upgraded. The remaining unused portions were retired with much of the excess track materials reused elsewhere.

The other of the two important system expansions was purchase of the operating assets of two smaller regional railroads, the Fox River Valley Railroad (FRVR) and the Green Bay and Western Railroad (GBW) in August 1993 from Itel Corporation through a newly created WCTC subsidiary, Fox Valley & Western, Ltd (FV&W). The purchase included about 480 miles of rail lines, along with attended property, agreements, rolling stock, equipment, and materials. The FV&W and WCL subsidiaries share locomotives, freight cars, shop facilities, rail yards, and administrative support. Savings are realized from the coordinated operations through consolidation of duplicative trackage, facilities, equipment, and operating and management staffs. Also, the coordination allows former FRVR and GBW traffic to have single line movement to Chicago and other gateways, with improved delivery times.

Attempts have been made to acquire the operations of smaller connecting links to directly serve nearby customers. For example, a six-mile branch serving a Kimberly-Clark paper mill at Munising, Michigan was purchased from a local railroad in 1989. In 1992, an unsuccessful bid was made for purchase of the 14-mile Tomahawk Railway which serves two mills and connects exclusively with the WC.

There exist other opportunities for further fine-tuning the system. The CNW still operates two isolated sections of railroad line in Wisconsin, both of which connect solely with the WC. One is a five-mile stretch in the Wausau area and the other is a 180-mile segment from Green Bay to Ishpeming, Michigan near Marquette. The latter segment offers an opportunity for the WC to eliminate a lengthy circuitous route into the Marquette area.

**Proactive Marketing**

At the start-up in 1987, the business plan relied primarily on originating, terminating, and local traffic, and not on overhead traffic as a base for revenues. Overhead traffic is susceptible to diversion over other railroads, making it very competitive, and usually having small profit margins. Accordingly, initial increases in carloadings and revenues were made by enlarging the
market share of freight shipped by existing customers, by regaining customers who had shifted to trucks when the railroad was operated by previous owners, and by serving new shippers in its territory. The railroad continues to build on its existing traffic base and increase its market share within the territory it serves rather than expanding much beyond Wisconsin and Michigan. Long-term multi-year agreements or contracts with major shippers such as The Mead Corporation have been made to help stabilize the traffic base. Maintaining a high level of service to paper industry customers and increasing the volume of intermodal traffic have received particular attention.

With a stable base of originating, terminating, and local traffic in existence, the company has begun targeting certain overhead traffic markets where conditions are favorable. In 1993, originating traffic accounted for 23 percent, terminating 37 percent, overhead 23 percent, and local traffic 19 percent of total carloads.

The acquisition and fine-tuning of the Superior line without the traffic restrictions imposed by the Soo opened two potentially large markets to build overhead traffic. The first market is attracting traffic which originates in western Canada, and then is routed to Duluth-Superior via the Canadian National (CN) rail system before continuing on to Chicago. This is a sizable market, estimated to be at least 75,000 carloads annually in the Duluth-Chicago corridor.12 While CN announced a joint haulage agreement with the Burlington Northern (BN) railroad for this traffic in 1992, freight routings remain the customers choice. The WC, which has the shortest route of any rail carrier between Chicago and Duluth-Superior has aggressively gone after this traffic, including opening its first off-line sales office in Vancouver, British Columbia. The WC's share of Duluth-Chicago rail traffic has been estimated to have increased from nothing in 1990 to 15 to 20 percent in 1993.13

The second market is the handling of iron ore largely in the Duluth-Superior to Chicago corridor. Traditionally, the economics of transporting iron ore dictated that lake boats handle the long haul of the ore from northern Minnesota and Upper Michigan to steel mills primarily in Indiana, Ohio, West Virginia, and Pennsylvania. During the 1980's, following deregulation, rail carriers had become more competitive. The Wisconsin Central serves both of the major iron ore
ranges that are active today in the United States. In 1987 and 1988, no iron ore was handled. In 1989, 17 trains containing 1,200 carloads were handled for the first time from Superior to Chicago. In 1993, 19,000 carloads of iron ore were handled, much of it on a year-round basis rather than only during the winter season when Great Lakes shipping is closed.14

In 1994, WC won a five-year contract with the Southern Pacific Railroad to move 26,000 carloads of ore from Minnesota's Mesabi iron range to the Geneva Steel mill in Utah. This traffic will ride the WC from Superior to Chicago. John Carey, Assistant Vice-President - Marketing has predicted that ore may be the railroad's number one commodity someday. WC has begun marketing itself as "America's year-round all-rail route for ore," including placing advertisements in mining industry magazines.15

**Physical Plant Improvements**

As part of the railroad's commitment to dependable service, investments have been made in upgrading and expanding facilities. Cross tie replacement, new ballast and rail, and general trackwork have been a major portion of each year's capital improvement budget. Also, acquisition of the Superior lines, the former Fox River Valley, and Green Bay and Western Railroads has enabled parts of several other railroad companies to be combined, while eliminating some bottlenecks and slow segments. Capacity-related improvements have also been made such as expansions of critical yard facilities at North Fond du Lac and Neenah, and changing mainline turnouts (switches) from manual operation to remote control.

**Cooperative Efforts With Public Sector**

An unusual proactive approach has been taken toward cooperating with the public sector along various avenues. For example, Metra -- the commuter passenger train operator in the Chicago area -- will be inaugurating a new commuter rail line in 1996 from downtown Chicago to Antioch, Illinois, of which 40 miles will be on the WC. Significant improvements to the existing track and signals that are required to operate this service are being funded from federal, state, and local public sources.
Other Investments

The company has reviewed other rail-oriented investments and looks to seizing such opportunities, if appropriate. In 1993, Wisconsin Central successfully participated as part of a consortium in a bidding process to acquire the New Zealand national railroad system (NZ Rail) from the New Zealand government. The total purchase price for the NZ Rail system was about $222 million (in U.S. dollars) for 2,500 route-miles of track, 270 locomotives, 6,000 freight cars, and ferry and freight forwarding operations. WC has a 29 percent interest in this rail operation and an option to purchase 3 1/2 percent more. This investment is expected to enhance the financial performance of WC and enable the exchange of expertise, technology, and ideas between the WC and NZ Rail.

Human Resources

The WC stresses the importance of the human factor in its operations. Again, President Ed Burkhardt, "When we formed this railroad we decided on a three-point program for dealing with our employees: stress good communications, reduce layoff fears, and treat everyone as if they were a part of management." 17

Good Communications - Burkhardt formally schedules employee meetings several times a year at the railroad’s major locations. Rank and file attendance at some of these meetings, however, has recently been rather light. In addition, he holds informal gatherings during his many visits across the system. His open communications philosophy has percolated down through the hierarchy and managers and corporate staff visits out on the line are the rule rather than the exception. This face to face interchange is supplemented by a quarterly newsletter, the Waybill, which keeps employees informed of the current status of operations. One innovation is an 800 number which allows WC employees to call any one at corporate headquarters to include Burkhardt. Many calls are aimed at solving problems but several are just to say “thanks.” 18

Reduced Layoff Fears - The WC places great emphasis on creating a stable work force. Judicious hiring to meet actual or forecast increased traffic demand minimizes subsequent layoffs during slack periods. Also, being non-union permits the assignment of employees to where they
are needed rather than to where work rules require. An active cross-training program also permits this desired flexibility. The end result is that furloughs are a rarity.

Table 4 shows the general increase in average employment during the last three years of operations.

<table>
<thead>
<tr>
<th>Table 4: Average Number of Employees</th>
<th>1991</th>
<th>1992</th>
<th>1993</th>
</tr>
</thead>
<tbody>
<tr>
<td>General and Administrative</td>
<td>91</td>
<td>92</td>
<td>101</td>
</tr>
<tr>
<td>Marketing</td>
<td>25</td>
<td>27</td>
<td>35</td>
</tr>
<tr>
<td>Engineering (maintenance of way)</td>
<td>254</td>
<td>287</td>
<td>379</td>
</tr>
<tr>
<td>Mechanical (maintenance of equipment)</td>
<td>199</td>
<td>219</td>
<td>284</td>
</tr>
<tr>
<td>Transportation (Engineers, Conductors, Brakemen)</td>
<td>362</td>
<td>408</td>
<td>568</td>
</tr>
<tr>
<td>Totals</td>
<td>931</td>
<td>1033</td>
<td>1367</td>
</tr>
</tbody>
</table>

SOURCE: Company Records.

Pay and Benefits - The company admitted from the beginning that it would be unable, at least in the short run, to match the pay of its unionized competitors. Pay ranges from 15 to 20 percent below comparable jobs and the work week often runs several hours longer. To partially offset this, the WC has placed all employees on salary and instituted a profit sharing plan. There are also pay raises when conditions warrant. The benefit package offered WC employees generally exceeds that provided by the unionized rail lines.

Train crew pay on the WC is based upon hours worked rather than distance traveled. Yard switching crews normally have an eight hour day while road crews work averages 10 to 11 hours. If required, crews perform both a switching and over-the-road duties in the same day. On unionized roads the 116 mile workday (often performed in three to four hours), coupled with ubiquitous work restrictions severely limit flexibility. Compensation increases in the last three years can be seen in Table 5.
Table 5: Compensation Increases

<table>
<thead>
<tr>
<th>Year</th>
<th>Percent Profit Sharing</th>
<th>Percentage Pay Raise</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>2.3</td>
<td>4.5</td>
</tr>
<tr>
<td>1992</td>
<td>5.2</td>
<td>3.5</td>
</tr>
<tr>
<td>1993</td>
<td>6.0</td>
<td>3.25</td>
</tr>
</tbody>
</table>

SOURCE: Company Records.

Training - The WC training program serves several purposes. First, it enables many employees to prepare themselves for better paying jobs. For example, those interested in the transportation area can apply to attend the one week train conductors' program or the eight week train engineers' course held in Stevens Point. These programs, coupled with seniority and increased business, permit temporary work as extra train crews and possible later movement to full time transportation status. In the interim, such employees continue to work in their original jobs.

As mentioned earlier, cross-training permits employees to perform multiple tasks, thus increasing their productivity and offering job protection. Line managers and key staff are kept current by attending American Management Association courses and university seminars.¹⁹

Hiring and Promotion - Job vacancies are posted and the WC's active training and development programs permit promotion from within whenever possible. The railroad also actively recruits and encourages employee referrals. The work force is predominantly white and male but an increasing number of females are beginning to fill key positions throughout the hierarchy.

Unions - The WC saw little union activity during its first five years of operations. The United Transportation Union (UTU) seemed to express some interest in early 1988 but never made a concerted effort to begin organizing. The Brotherhood of Locomotive Engineers (BLE) attempt in 1990 to represent engineers and separately trainmen (conductors and brakemen) failed when only 21 percent of the former and 15 percent of the latter voted affirmatively.

The acquisition of the GB&W and FRVR brought with them a January 1994 National Mediation Board (NMB) requirement that their former unions be recognized as the collective
bargaining representative of FV&W's employers. The WC has since countered that the WC-
FV&W are operated as a single system and that any unionization activity must apply to both
equally. The NMB currently has this matter under advisement.

In March 1994 the NMB notified the company that the UTU had claimed it had enough
Authorization Cards to have a representation election among WC engineers and conductors. Late
July 1994 finds the NMB investigating the accuracy of the union count.

Service and Marketing

The marketing of services is guided by WC's goals of providing frequent and dependable
freight service at competitive prices by customer-minded employees. To accomplish this, all
regular freight trains are scheduled so that they can connect in an efficient manner with each other
as well as with other carrier's trains. WC trains adhere to their schedules allowing for a high
degree of schedule predictability for individual cars, fast transit times, and reliable arrival estimates
for shippers. This is in contrast to many in the railroad industry operations wherein trains operate
as unscheduled extras that departed only after certain tonnage requirements are filled. Keeping the
cars moving and not waiting at intermediate yards also helps minimize car-hire expenses, typically
a large operating expense on any railroad. The strict scheduling of trains also improved car
utilization. For example, some cars that used to make three or four round trips per month on the
previous carrier now make eight on the WC.20

Dependent Upon National System

Because most rail freight carriers in the United States must cooperate and function together
as a nationwide system, problems with one railroad may affect others. Nowhere is this more
obvious than at Chicago, which remains the busiest and most important gateway for the national
rail system as well as the WC. For example, major snowstorms and subzero temperatures during
the winter of 1993-1994 caused delays for all railroads, disrupted interchanges, and caused factory
shutdowns. As a result, trains became difficult to move and yards in Chicago became plugged,
making it impossible for the WC to deliver and pick up cars until yard tracks could be cleared. Like
other railroads, the WC found itself short of crews and locomotives. This situation was on the heals of the additional traffic generated by the FV&W acquisition, which the railroad had not fully adjusted to.21

Customer Communication

Constant communication between the railroad and its 500-plus customers is emphasized. Unlike other railroads, WC operating personnel, to include train crews, are responsible for day-to-day contact with customers. Shippers also have direct access to an assigned marketing representative who knows their products, markets and shipping requirements. This person is responsible for pricing and marketing assistance for both inbound and outbound shipments.

TCS

An important tool is a state-of-the-art system of integrated computer programs known as the Transportation Control System (TCS) which covers train and terminal operations, car scheduling, exchanging data with other carriers, waybill and billing functions, car accounting and distribution, equipment maintenance, marketing data, and operations status reports. TCS also allows customers to do their own billing and car tracing functions. To keep customers informed of railroad activities and progress, a professionally produced bimonthly newsletter is widely distributed.


As previously mentioned, the WC has continued to improve its financial condition since startup in 1987. The railroad generated $113.7 million in operating revenues in 1991, while traffic volume was 179.7 thousand carloads. Operating revenues for 1992 were $124.4 million and traffic volume 205.5 thousand carloads, a 9.4 percent increase in revenues and a 14.4 percent rise in traffic volume. In 1993 WCL had $151.7 million in operating revenue with 257.3 thousand carloads, an increase of 21.9 and 25.2 percent over comparable 1992 levels. During the first six months of 1994 operating revenues were $101.3 million compared to $67.6 million for the same
period in 1993, a 49.8 percent increase. At the same time, carloadings increased 50 percent as compared to a similar period in 1993. Net income during the last three full years of operation increased from $8.2 in 1991 to $15.4 million in 1993. Net income during the first six months of 1994 increased 14.1 million. Undoubtedly the greatest indicator of success has been expressed by the investors who have bid the WCTC stock from an initial May 1991 offering of $16.50 per share to the low $70s in late Spring 1994. A July 5th, 1994 two-for-one stock split has been followed by a $41 per share price by early August. Supporting data plus other comparisons can be found in Table 6 (Condensed Consolidated Statements of Income).

<table>
<thead>
<tr>
<th>Table 6: Wisconsin Central Transportation Corporation and Subsidiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Condensed Consolidated Statements of Income</td>
</tr>
<tr>
<td>($ in thousands, except per share data)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td><strong>Six Months Ended June 30, 1994</strong></td>
</tr>
<tr>
<td>(Unaudited)</td>
</tr>
<tr>
<td>Income Statement Data:</td>
</tr>
<tr>
<td>Operating revenues</td>
</tr>
<tr>
<td>Operating expenses</td>
</tr>
<tr>
<td>Income from operations</td>
</tr>
<tr>
<td>Gains on Sales of excess assets</td>
</tr>
<tr>
<td>Rental income</td>
</tr>
<tr>
<td>Other income (expense), net</td>
</tr>
<tr>
<td>Interest expense</td>
</tr>
<tr>
<td>Income (loss) before income taxes and extraordinary items</td>
</tr>
<tr>
<td>Provision for income taxes</td>
</tr>
<tr>
<td>Income (loss) before extraordinary items</td>
</tr>
<tr>
<td>Equity in Net Income of Affil.</td>
</tr>
<tr>
<td>Income before Extraordinary Item and Cumulative Effect</td>
</tr>
<tr>
<td>of Accounting Change</td>
</tr>
<tr>
<td>Extraordinary item--early extinguishment of debt, net of</td>
</tr>
<tr>
<td>income taxes</td>
</tr>
<tr>
<td>Cumulative effect on prior years of change in methods for</td>
</tr>
<tr>
<td>income taxes</td>
</tr>
<tr>
<td>Net income (loss)</td>
</tr>
<tr>
<td>Net income (loss) per share (dollars)</td>
</tr>
</tbody>
</table>

Wisconsin Central Transportation Corporation, 1994, 2nd Quarter Form 10-Q, p. 3.
Revenues - Traffic volume during the period increased in all 14 commodity groups with an overall increase of 78 thousand carloads, a 43.5 percent increase. Approximately half of this growth is due to the acquisition of FV&W and the Ladysmith line. While gross revenues increased, per carload averages decreased in all groups. Table 7 compares the WCL’s 1991-1993 traffic volume, gross and average revenues for carload by commodity group:

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Paper</td>
<td>26,844</td>
<td>23,420</td>
<td>22,038</td>
<td>$25,466</td>
<td>$21,938</td>
<td>$21,340</td>
<td>$949</td>
<td>$937</td>
<td>$968</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Woodpulp</td>
<td>27,368</td>
<td>19,091</td>
<td>18,270</td>
<td>21,519</td>
<td>17,376</td>
<td>17,911</td>
<td>786</td>
<td>910</td>
<td>980</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Pulpboard</td>
<td>15,453</td>
<td>13,196</td>
<td>14,290</td>
<td>8,095</td>
<td>7,446</td>
<td>8,080</td>
<td>524</td>
<td>564</td>
<td>565</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lumber products</td>
<td>15,229</td>
<td>9,642</td>
<td>7,021</td>
<td>9,555</td>
<td>6,403</td>
<td>4,407</td>
<td>627</td>
<td>664</td>
<td>628</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wood fibers</td>
<td>18,387</td>
<td>18,176</td>
<td>15,467</td>
<td>9,229</td>
<td>8,544</td>
<td>7,802</td>
<td>502</td>
<td>470</td>
<td>504</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chemical and petroleum products</td>
<td>25,553</td>
<td>19,668</td>
<td>16,817</td>
<td>21,553</td>
<td>17,622</td>
<td>15,186</td>
<td>843</td>
<td>898</td>
<td>903</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Intermodal</td>
<td>31,710</td>
<td>30,791</td>
<td>28,343</td>
<td>4,402</td>
<td>5,421</td>
<td>5,664</td>
<td>139</td>
<td>176</td>
<td>200</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sand, stone and minerals</td>
<td>29,133</td>
<td>19,358</td>
<td>8,402</td>
<td>12,715</td>
<td>7,613</td>
<td>4,316</td>
<td>436</td>
<td>393</td>
<td>514</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clay products and granules</td>
<td>17,461</td>
<td>14,738</td>
<td>13,231</td>
<td>16,322</td>
<td>14,031</td>
<td>12,696</td>
<td>935</td>
<td>952</td>
<td>960</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Coal</td>
<td>14,145</td>
<td>10,799</td>
<td>13,663</td>
<td>7,062</td>
<td>5,567</td>
<td>7,240</td>
<td>499</td>
<td>516</td>
<td>530</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Food and grain</td>
<td>18,288</td>
<td>14,341</td>
<td>11,479</td>
<td>11,928</td>
<td>9,519</td>
<td>7,475</td>
<td>652</td>
<td>664</td>
<td>651</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Waste and Scrap</td>
<td>10,990</td>
<td>7,802</td>
<td>6,748</td>
<td>6,932</td>
<td>5,492</td>
<td>4,981</td>
<td>631</td>
<td>704</td>
<td>738</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Steel</td>
<td>3,568</td>
<td>2,657</td>
<td>2,144</td>
<td>4,210</td>
<td>3,376</td>
<td>2,823</td>
<td>1,180</td>
<td>1,271</td>
<td>1,317</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2,197</td>
<td>1,833</td>
<td>1,810</td>
<td>1,760</td>
<td>1,423</td>
<td>1,158</td>
<td>550</td>
<td>776</td>
<td>640</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>257,326</td>
<td>205,512</td>
<td>179,723</td>
<td>$160,748</td>
<td>$131,811</td>
<td>$121,079</td>
<td>$625</td>
<td>641</td>
<td>674</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Operating Expenses - Expenses were $116.8 million in 1993 as compared to $98.9 million in 1992 and $91.2 million in 1991. Table 8 provides a comparison of WC's expenses during this time period.

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Labor expense (including payroll taxes and fringe benefits)</td>
<td>49,951</td>
<td>41,875</td>
<td>38,265</td>
</tr>
<tr>
<td>Diesel Fuel</td>
<td>10,194</td>
<td>8,204</td>
<td>7,852</td>
</tr>
<tr>
<td>Materials</td>
<td>10,968</td>
<td>9,688</td>
<td>8,698</td>
</tr>
<tr>
<td>Equipment rents, net</td>
<td>18,268</td>
<td>16,719</td>
<td>14,144</td>
</tr>
<tr>
<td>Joint facilities, net</td>
<td>792</td>
<td>1,369</td>
<td>2,395</td>
</tr>
<tr>
<td>Depreciation</td>
<td>6,838</td>
<td>5,783</td>
<td>5,480</td>
</tr>
<tr>
<td>Casualties and insurance</td>
<td>4,771</td>
<td>4,103</td>
<td>3,852</td>
</tr>
<tr>
<td>Property taxes</td>
<td>3,224</td>
<td>2,173</td>
<td>2,315</td>
</tr>
<tr>
<td>Other</td>
<td>11,837</td>
<td>8,094</td>
<td>8,228</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>$116,843</td>
<td>$98,008</td>
<td>$91,229</td>
</tr>
</tbody>
</table>


Labor expenses increased some $11.7 million during the period. These increases were due to: an enlarged work force, pay raises and employee bonuses plus associated fringe benefit costs.

Diesel fuel expenses rose $2.3 million, or 29.8 percent, during the period as consumption increased by 38.9 percent on a 52.8 percent increase in gross ton miles. The decline in fuel consumption per ton mile was due to operating efficiency improvements. Fuel expenses were also kept in check because of hedge arrangements and a decline in per gallon prices. Materials expenses rose as increased business levels required additional locomotives, freight cars, and track materials. Equipment rents increased due to additional car hire and equipment lease requirements. The remaining expense increases were attributable to the FV&W and Ladysmith line acquisitions. The company’s operating ratio (operating expenses divided by operating revenues) decreased from
80.3 percent in 1991 to 78.8 percent in 1992, 77.0 percent in 1993, and was at 73.1 percent as of July 1, 1994.

**Liquidity and Capital Resources** - Cash generated from operations has historically been the WC's primary source of liquidity and is used principally for debt service, capital expenditures and working capital requirements. The company also acquires cash from sale of assets and financing activities. During the five year period (1989-1993) the company's sources and uses of cash included (see Table 9):

<table>
<thead>
<tr>
<th>Source</th>
<th>Use</th>
<th>($ in millions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Operations</td>
<td>Capital Expenditures</td>
<td>$145.0</td>
</tr>
<tr>
<td>Asset Sales</td>
<td>Asset Acquisition</td>
<td>96.6</td>
</tr>
<tr>
<td>Debt Issue</td>
<td>Debt Retirement</td>
<td>192.3</td>
</tr>
<tr>
<td>Equity Issue</td>
<td>Railroad Investment</td>
<td>16.0</td>
</tr>
<tr>
<td></td>
<td>Working Capital</td>
<td>4.3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>Total</strong></td>
<td><strong>$454.2</strong></td>
</tr>
</tbody>
</table>


The three years (1991-1993) saw the company invest some $32 million to purchase additional locomotives and freight cars. An additional $57.6 million was spent on roadway and structure improvement as indicated in Table 10.

<table>
<thead>
<tr>
<th>Table 10: Roadway and Structure Improvements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year Ended December 31.</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Track miles surfaced (1)...................</td>
</tr>
<tr>
<td>Track miles of rail laid...................</td>
</tr>
<tr>
<td>Tons of ballast applied (thousands).......</td>
</tr>
<tr>
<td>Ties installed (thousands).................</td>
</tr>
</tbody>
</table>

(1) Surfacing is the process by which track was aligned and cross-leveled in conjunction with the application of ballast and the installation of ties.

By late July, the WC had passed the half-way mark of the 1994 planned laying of 220 thousand tons of ballast, 35 miles of welded rail and installing 165 thousand ties.

At December 31, 1993, the WC had $134.2 million of debt outstanding which constituted 47.3 percent of total capitalization. The railroad has an aggregate borrowing capacity of $150 million under various bank loan facilities and at year end had $75.8 million unused. Cash flows from operations plus bank loan facilities should more than satisfy liquidity and capital expenditure requirements. Table 11 on the following page gives recent consolidated balance sheet data.

**External Environment: Economic**

**National**

The economy in the United States has shown reasonable growth since the recession ended during the first quarter of 1991. Gross Domestic Product (GDP) has grown at 2.9 percent during this three year period that saw only five quarters at or above the moderate growth rate of 3 percent. Forecasts call for 3 percent GDP growth for the remainder of 1994 and a 2.75 percent increase in 1995. Inflation should remain at around 3 percent and interest rates continue to edge upward. Railcar loadings have lagged GDP falling 2.5 percent in 1991, increasing 1.1 percent in 1992 and 2.4 percent in 1993. Through June 4, 1994, commodity freight carloadings were up 3.8 percent and intermodal ahead by 13.2 percent as compared to a like time period in 1993. Increases in traffic for the remainder of 1994 are expected in such areas as: intermodal, chemicals, lumber, paper, metallic ores, motor vehicles, stone, clay and glass.

**Regional**

The State of Wisconsin is characterized by a variety of diversified and productive manufacturers supported by a highly educated labor force with a strong work ethic. According to a recent study on the state's economy by the University of Wisconsin School of Business, the state has been particularly strong in durable goods production, especially industrial machinery, primary and fabricated metals, lumber, and instrumentation.22
### Table 11: Wisconsin Central Transportation Corporation and Subsidiaries
Condensed Consolidated Balance Sheets ($ in thousands)

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Current Assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>$4,823</td>
<td></td>
<td>$4,677</td>
<td>$37,979</td>
<td></td>
</tr>
<tr>
<td>Receivables</td>
<td>39,796</td>
<td></td>
<td>32,839</td>
<td>23,480</td>
<td></td>
</tr>
<tr>
<td>Materials and supplies</td>
<td>15,881</td>
<td></td>
<td>12,846</td>
<td>9,055</td>
<td></td>
</tr>
<tr>
<td>Other current assets</td>
<td>2,289</td>
<td></td>
<td>2,513</td>
<td>1,154</td>
<td></td>
</tr>
<tr>
<td><strong>Total current assets</strong></td>
<td>62,789</td>
<td></td>
<td>52,875</td>
<td>71,668</td>
<td></td>
</tr>
<tr>
<td>Investment in Affiliate:</td>
<td>23,428</td>
<td></td>
<td>17,532</td>
<td>---</td>
<td></td>
</tr>
<tr>
<td><strong>Properties:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Roadway and structures</td>
<td>---</td>
<td></td>
<td>300,036</td>
<td>205,550</td>
<td></td>
</tr>
<tr>
<td>Equipment</td>
<td>---</td>
<td></td>
<td>45,174</td>
<td>20,385</td>
<td></td>
</tr>
<tr>
<td><strong>Total properties</strong></td>
<td>363,119</td>
<td></td>
<td>345,210</td>
<td>225,935</td>
<td></td>
</tr>
<tr>
<td>Less accumulated depreciation</td>
<td>(35,722)</td>
<td></td>
<td>(31,010)</td>
<td>(23,544)</td>
<td></td>
</tr>
<tr>
<td><strong>Net properties</strong></td>
<td>327,397</td>
<td></td>
<td>314,200</td>
<td>202,391</td>
<td></td>
</tr>
<tr>
<td><strong>Other assets:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deferred financing &amp; organization costs, net</td>
<td>4,039</td>
<td></td>
<td>4,575</td>
<td>3,995</td>
<td></td>
</tr>
<tr>
<td>Deferred acquisition costs</td>
<td>---</td>
<td></td>
<td>---</td>
<td>2,768</td>
<td></td>
</tr>
<tr>
<td><strong>Total other assets</strong></td>
<td>4,039</td>
<td></td>
<td>4,575</td>
<td>6,763</td>
<td></td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>$417,653</td>
<td></td>
<td>$380,182</td>
<td>$280,822</td>
<td></td>
</tr>
</tbody>
</table>

### Liabilities and Stockholders' Equity

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Current liabilities:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long-term debt due within one year</td>
<td>$---</td>
<td></td>
<td>$---</td>
<td>$146</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>27,441</td>
<td></td>
<td>27,653</td>
<td>16,727</td>
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<tr>
<td>Accrued expenses</td>
<td>40,111</td>
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<td>33,917</td>
<td>21,531</td>
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<tr>
<td>Interest payable</td>
<td>2,006</td>
<td></td>
<td>1,544</td>
<td>1,544</td>
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<tr>
<td><strong>Total current liabilities</strong></td>
<td>69,958</td>
<td></td>
<td>63,114</td>
<td>39,948</td>
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<tr>
<td><strong>Long-term debt</strong></td>
<td>131,555</td>
<td></td>
<td>134,155</td>
<td>81,428</td>
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<tr>
<td><strong>Other liabilities</strong></td>
<td>4,923</td>
<td></td>
<td>6,414</td>
<td>2,798</td>
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<tr>
<td>Deferred income taxes</td>
<td>36,895</td>
<td></td>
<td>29,263</td>
<td>18,002</td>
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<tr>
<td><strong>Deferred income</strong></td>
<td>6,269</td>
<td></td>
<td>6,562</td>
<td>4,961</td>
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<tr>
<td><strong>Total liabilities</strong></td>
<td>249,600</td>
<td></td>
<td>239,508</td>
<td>147,137</td>
</tr>
<tr>
<td><strong>Stockholders' equity:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Preferred stock par value $1.00; authorized 1,000,000 shares; none issued and outstanding</td>
<td>---</td>
<td></td>
<td>---</td>
<td>---</td>
</tr>
<tr>
<td>Common stock, par value $0.01; authorized 40,000,000 shares; issued and outstanding 8,276,983 shares in 1993 and 8,244,707 shares in 1992</td>
<td>---</td>
<td></td>
<td>---</td>
<td>83</td>
</tr>
<tr>
<td>Paid in capital</td>
<td>---</td>
<td></td>
<td>101,006</td>
<td>100,389</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>---</td>
<td></td>
<td>48,585</td>
<td>33,214</td>
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<tr>
<td><strong>Total stockholders' equity</strong></td>
<td>168,053</td>
<td></td>
<td>149,674</td>
<td>133,685</td>
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<tr>
<td><strong>Total liabilities and stockholders' equity</strong></td>
<td>$417,653</td>
<td></td>
<td>$389,182</td>
<td>$280,822</td>
</tr>
</tbody>
</table>

Wisconsin Central Transportation Corporation, 1994, 2nd Quarter Form 10-Q, p. 2.
The paper industry is of prime importance to Wisconsin, employing about 50,000 people, or nine percent of the state manufacturing employment. In 1992, Wisconsin ranked first among all states in paper industry employment and in paper production, producing over 4.6 million tons of paper, or 11 percent of the nation's total output. Of the over 82 active pulp and paper mills in Wisconsin and the UP of Michigan, 69, most of them large capacity, are directly served by WC. Of the other 13 mills, 9 are located on railroad lines whose only interchange is with the Wisconsin Central. The railroad also serves a mill in Sault Ste. Marie, Ontario.

Large capital expenditures for expansion and modernization at these mills during the 1980s and continuing into the 1990s is expected to help maintain Wisconsin's dominant position as a papermaker. These investments are not only going toward expansion, but also to increase the plants' ability to utilize wastepaper and to meet tighter environmental standards. Wisconsin forest resources are plentiful. Although the harvesting of timber has been increasing, only about 60 percent of the forest growth has been cut in recent years. Eight major paper converting mills are also located on WC in Wisconsin.

Printing and publishing are also a big business in Wisconsin. One of the state's largest, Quad/Graphics, has three plants located on WC's lines, all of which were designed to receive printing paper by rail. Other major manufacturing concerns directly served by the railroad include firms that produce food products, lumber and wood products, chemicals, fabricated metals, electrical machinery, and plastics.

Mining is expected to remain a relatively small industry in Wisconsin, mostly engaged in the extraction of sand, gravel, and stone. Some metallic minerals including copper and gold are mined in the state near Ladysmith. The WC has begun hauling carloads of ore from this mine to Sault Ste. Marie for interchange to Canadian destinations. Copper and zinc deposits have also been found in northeastern Wisconsin near Crandon. It is anticipated that a mine will eventually become operational in this area once economic and environmental reviews have been satisfied. In Michigan, the White Pine Copper Mine, near Ironwood; is increasingly using WC for delivery of copper concentrates, grinding media and coal and shipment of copper cathodes.


**Competition**

WC's operations are subject to competition from other railroads, trucks, and water carriers. Railroad competition is primarily in the Duluth-Superior to Chicago market. The WC competes for interchange traffic at Duluth-Superior with the Burlington Northern, Soo Line/CP Rail System, and Chicago and North Western railroads. Both general freight coming down from Canada and iron ore from northern Minnesota can be hauled by any of these railroads to Chicago.

Trucks dominate the transportation market area of the WC. In the all-important paper industry, WC handles the majority of inbound raw materials, chemicals, coal, and clay. Outbound paper products transported by rail consisted of printing paper, kraft (brown) paper, and pulpboard. The WC has won back some sheet paper, consumer, and sanitary products business but the majority of this traffic remains with trucks due to relatively low product weight and off-line delivery requirements.

The WC competes with water carriers primarily for the movement of iron ore from northern Minnesota to Indiana, Ohio, Pennsylvania, and West Virginia. Movement of iron ore by boat is seasonal and cannot occur when the Great Lakes ports and locks are frozen during the winter. Coal deliveries to a copper mine in White Pine, Michigan can be shipped by rail but have traditionally been handled by boat. The WC is generally too far north to be greatly affected by barges operating on inland waterways.

**External Environment: Political/Government**

**Legal/Political**

The WC is subject to numerous federal, state, and local laws and regulations pertaining, in varying degrees, to almost every phase of its operations. Federal—Government programs and policies which influence the strength of the dollar, export/import, crop support prices and interest rates, greatly affect most sectors of the economy and therefore WC.
Major federal legislation aimed specifically at rail industry enhancement includes:

1. The 1976 Railroad Revitalization and Regulatory Reform Act (4Rs)–freed the railroads of 75 year old regulations that may have been appropriate before the coming of the truck and the airplane. Railroads were permitted greater flexibility in rate making, abandonments, mergers and line sales. Federal funds were provided through state agencies to rehabilitate needed rail trackage. Individual states were required to become involved in rail planning.

2. The Staggers Rail Act of 1980 enhanced the work of the 4R’s Act. It further streamlined the mechanics of restructuring the physical rail system and rail rate structure. It allowed railroads to either increase net revenues on unprofitable branchlines or to redirect traffic and abandon them.

3. Rural Rail Infrastructure Act of 1993 has been introduced by Congress and would mandate $100 million a year in matching fund grants to the states and provide for $500 million in funded loan guarantees. These monies are aimed principally for secondary rail lines.

4. North American Free Trade Agreement (NAFTA) of 1993 eliminates or greatly reduces trade barriers among the U.S., Canada, and Mexico. It is estimated that this agreement will create a $6 trillion tariff-free market within a decade. The railroads of the three countries are coordinating operating practices and streamlining border crossing procedures.

Other pertinent federal legislation is:

1. Highway Trust Fund–Has subsidized truck use of the highway network. Over $125 billion is to be spent exclusively on highways over the next five years while railroad support under the 4R’s Act is running $8-10 million a year.24

2. Federal Employee’s Liability Act–Is a form of workers’ compensation mandated for the railroad industry. Unlike workers’ compensation, it is an adversarial system rather than
a no-fault. As a result, average cost per employee hour worked is $1.51 for railroads and $0.27 for the rest of American Industry.25

3. Railroad Retirement Act—Requires heavier railroad contributions than employers under the social security system.26

4. Safety User Fees—Railroads must fund federal safety inspections of their track and equipment ($32 million in 1992) while truck and barge competitors do not have this requirement.27

State and Local Activities

State and local government interaction with the railroad industry has traditionally centered only on selected issues such as safety, grade crossings, branchline abandonments, and freight service preservation. To a large degree, this is due to railroads being for-profit concerns that own and operate over their own rights-of-way, unlike trucks and barges which have operated over publicly owned and maintained rights-of-way. During the 1970's and 1980's, the State of Wisconsin's rail programs and policies -- like most states -- focused on preservation of certain light density branch lines and service provided by major railroads facing bankruptcy. Thus, Wisconsin's rail policies and programs were able to address: preservation of endangered rail line segments; track rehabilitation assistance on light density lines; and mitigation of abandonment impacts on rail using businesses.

WC has participated in several of these programs. For example, in 1990, the railroad completed rehabilitation of the 46-mile long Manitowoc branch using a $1.25 million grant and a $750,000 low interest loan from the State. Also, in 1989 the State of Michigan approved a $300,000 loan to WC to upgrade 19 miles of mainline track.

More recently, Wisconsin officials recommended that the state's rail freight policies and programs be modified to change their focus from that of service preservation to economic development. In a recent completed Freight Rail Policy Plan,28 the Wisconsin Department of Transportation suggested a series of actions which include: the state constitution's "internal improvements" clause be revised to allow the state to directly make rail improvements; allowing the
state to have the ability to directly manage the use of state owned rail lines; and expanding the requirements in the track rehabilitation program to include a broader range of eligible rail lines. Other recommended actions included additional legislative items dealing with grade crossings and right-of-way fencing.

In 1993, Wisconsin's governor and the state legislature approved a freight railroad infrastructure improvement program which made up to $11 million in loans available from a revolving fund for upgrading rail lines. WC officials have indicated an interest in using funds from this program for such projects as rehabilitating the Ashland to Prentice line, constructing new pulpwood log loading centers in northern Wisconsin, expanding the yard at Neenah, and eliminating other operational bottlenecks.

**Bibliography**


3. Ibid., p. 32.

4. Ibid., p. 3.


9. Ibid.


14. Wisconsin Central Ltd. and Fox Valley & Western Ltd., Waybill (Employee Newsletter), April 1994, pp. 4-5.

15. Ibid., pp. 4-5.


25. Ibid.

26. Ibid.

27. Wisconsin Department of Transportation, Division of Planning and Budget, Freight Rail Policy Plan, Madison Wisconsin, January 1992, pp. 1-6, 47-69.
WISCONSIN CENTRAL – 1994: CONTINUING SUCCESS IN THE RAILROAD INDUSTRY

INSTRUCTOR’S MANUAL

by

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WISCONSIN CENTRAL – 1994: CONTINUING SUCCESS IN THE RAILROAD INDUSTRY

Case Overview

Approximately 25 years ago a majority of the railroads in the industry were either in or near bankruptcy. As a partial cure, a series of federal and state legislation was enacted which freed the industry from archaic laws passed in the days railroads enjoyed a virtual monopoly in U.S. transportation. One of the outcomes of this new legislation was the freedom granted major railroads to abandon or to sell off excess trackage to entrepreneurs. The Wisconsin Central (WC) is a regional railroad that was spun off from the Soo Line Railroad in 1987 and purchased by a group of entrepreneurs. The case traces the WC's last three years of operations which have seen steadily increasing business, revenues and net income. Operating in a hostile environment, the WC has succeeded as a result of innovative management, marketing, operating and HRM practices. Utilizing a mix of market penetration and horizontal integration, the railroad is in some danger of being the victim of its own success. Mushrooming traffic seems to stay ahead of the WC's capacity to handle it. Increasing customer dissatisfaction coupled with employee complaints of 10 and 11 hour days does not bode well for the company. Is it time for the WC to pause until it gets its house in order?

Objectives

1. To introduce the student to the nature of the regional railroad segment of the U.S. rail industry.

2. To analyze the leadership techniques utilized by management.

3. To study the innovative marketing strategy utilized by WC.

4. To acquaint the student with the HRM practices of WC.

5. To identify the functional area techniques used by an organization operating successfully in a hostile external environment.

6. To determine the appropriateness of a change in corporate strategy at a time when an existing strategy is proving quite successful.
Courses and Levels

This case is appropriate for courses in business strategy, marketing management, transportation, HRM and entrepreneurship at the undergraduate and graduate levels.

Discussion

Q. 1. What are strengths of WC?

A. The case is replete with strengths, those of particular importance include:

1) Management - President Ed Burkhardt and his principal assistants make up an innovative team that encourages employee participation.

2) Promotion - face-to-face dealings with current and potential customers has proven quite successful. Railroad has received a great deal of "free" publicity from favorable articles in newspapers, trade journals and railroad magazines.

3) Price - small train crews and flexible work rules permit the WC to underbid other railroads and be more competitive with trucks.

4) Product - Fast, frequent, and usually reliable service emphasizing customer needs is key to the railroads marketing mix.

5) HRM - Has excellent benefit package. Training program encourages career pathing and affords flexibility. Open door policy and 800 number to president popular with workers.

6) Culture - Teamwork oriented, where service to customer is all important.

7) Operations - Hub and spoke concept along with scheduled trains proving successful.

8) Finance - Successful stock offering has greatly improved balance sheet. Profitability improving every year.

9) MIS - Customer Service Center and Transportation Central System both permit the railroad and it's customers to maintain real time information.

Q. 2. What are WC's main weaknesses?

A. WC's weaknesses include:

1) In spite of Herculean efforts, WC's capacity lags demand.
2) Salaries and working hours are not competitive
3) The WC is over-reliant on the paper industry.
4) Rail lacks the inherent flexibility of trucks.
5) With a large fixed physical plant, the WC can not easily reallocate its efforts or adjust its traffic mix.
6) Some of WC's many rail lines are reaching capacity.
7) Liquidity and leverage ratios indicate possible problems during severe economic down-turn.

Q. 3. What are the opportunities facing WC?

A. WC's opportunities include:

1) Intermodal traffic - increasingly on line customers see WC as a reliable option for moving trailers to and from Chicago for further dispatch.
2) Paper Industry - Will continue to be a major WC customer. Carload comparison data in Table 7 suggests future increases of rail appropriate freight.
3) Overhead traffic - The CN connection in Duluth and the Canadian Pacific connection in Sault Saint Marie could offer increasing business for delivery to U.S. rail lines in Chicago and Minneapolis.
4) Mining - several on-line areas in Wisconsin and Michigan are being actively considered as copper mining sites. This type of traffic is normally moved by rail.
5) Legislation - Both federal and state legislation appears favorable and state funds should continue to provide monies for roadbed improvements.
6) Iron ore - iron ore is increasingly being shipped by rail from mines to steel mills.

Q. 4. What are the threats facing WC?

A. WC's threats include:

1) Trucks - This mode is by far the most dangerous competitor. Rail market share loss is virtually matched by truck market share gain. The WC has regained some business
from trucks but trucking has many inherent advantages that preclude any major shifts in market share.

2) Rail - Current direct competitors are relatively minor threats, except in WC’s purchase of Duluth Superior to Chicago market where CNW, Soo and BN are major factors.

3) Unions - To date, unions have been unable to organize the WC. This may change as 11 and 12 hour days are a major irritant to operating employees.

4) Economy - Rail freight is particularly sensitive to the state of the economy. The WC is partially shielded by its dependence upon the recession resistant paper industry. Fifty percent of WC traffic is paper related.

Q. 5. What corporate strategy has WC been following since its organization?
A. The WC has been following a market penetration/horizontal integration strategy. Overhead traffic received from one railroad and delivered to another is beginning to be emphasized. The WC has gained shippers plus rail connection by purchasing other smaller rail roads in Wisconsin and Ontario, Canada.

Q. 6. Should the WC consider a pause strategy?
A. Definitely. The WC’s credo of fast, reliable service is becoming blurred by the endless striving for more business. Operating employee discontent is evident by increasing union activity. A 3-6 month “let’s get organized” period should permit the hiring of more train crews, scheduling more trains and unplugging the railroad. The end result should be happier customers and employees.

Analysis
Current Situation:

The WC has continued to improve its financial position during the last three years. Utilizing a mix of market penetration and horizontal integration, the railroad finds that it is operating at capacity or beyond. Customer and employee complaints indicate that a pause may be in order.
Current Mission:

In the words of President Ed Burkhardt, "to offer superior transportation consisting of more frequent, dependable train service at competitive prices, with proper equipment, accomplished by customer-minded employees." The railroad's actions indicate that implicitly the mission includes, "with emphasis on, on-line customers."

Current Objectives:

1. The mission statement is a series of six objectives i.e., frequent train service, dependable train service, etc.
2. Increase multi-year, long-term traffic agreements.
3. Treat employees fairly
4. Remain non-union
5. Increase share of intermodal business.
6. Increase ore traffic.
7. Increase capacity.
8. Continue roadway improvement program.

Current Strategy:

The railway has been following a market penetration/horizontal integration strategy. At case end the WC is pondering the need for a pause strategy.

Strategic Managers:

A. WC's Board of Directors consists of 7 members.
   1. Four members are insiders.
   2. The board is young and several have considerable rail experience.
   3. The company has recently turned public and several board members hold or represent major stock positions.

B. Top management is ably led by Ed Burkhardt who possess a great deal of rail operational experience.
   1. Management divided by function
2. Background is diverse and experienced
3. Appear to work well with CEO and each other.

External Analysis:

A. Opportunity
1. The paper industry continues to grow in the upper Midwest and is relatively recession proof.
2. Intermodal traffic is a growing segment of the rail traffic mix. On-line customers are beginning to move more trailers on WC.
3. Canadian rail connections are beginning to route more of their Midwest U.S. traffic via WC.
4. Several copper deposits lie near WC. Operating mines move their ore to smelter via WC.
5. Both federal and state legislation appears rail favorable and state funds should continue to provide monies for rail bed improvements.

B. Threats
1. Trucks are inherently more flexible than rail for many commodities. The trucking industry market share gains virtually match rail share losses.
2. Rail competition is currently a minor threat to WC except along the Duluth-Superior-Chicago corridor.
3. Two attempts to unionize WC have failed. Long hours and employees brought in under FV&W purchase have caused a renewed interest in unionization.
4. Rail freight is particularly economy sensitive. WC's paper traffic helps buffer the road during minor recessions.
5. Possible EEO problems caused by predominately white male work force.

Internal Analysis:

A. Corporate
1. Strengths
1. The WC is organically structured in a changing environment
2. Daily decisions are handled at the functional level

2. Weakness
   Too growth oriented?

B. Culture
   1. Strengths
      a) Open door
      b) Employees are partners
      c) Customers are WC's life blood
      d) Strong work ethic
      e) Innovation encouraged
   2) Weakness
      a) Emphasis on growth may be hurting WC, at least in short run.
      b) Predominately white male work force.

C. Marketing
   1. Strengths
      a) Target market has expanded from all current and former on-line customers to include off-line customers and connecting railroads.
      b) Product is fast, reliable service directed towards customer needs rather than railroad's convenience. Very innovative in nature.
      c) Price is very competitive in the rail mode and coupled with reliable service attractive in the intermodal arena.
      d) Promotion is a combination of operating and sales employees, word of mouth, and a very favorable press.
      e) Place is favorable in that the WC lies in the heart of the growing Wisconsin paper belt.
3. Weakness
   a) WC’s main target market is too paper industry reliant. The railroad has targeted other customers with increasing success but still receives over 40 percent of its revenue from paper.
   b) Place is also a weakness because large fixed physical plant limits flexibility in market mix.

D. Finance
   1. Strengths
      a) WC is an increasingly profitable operation.
      b) Good use of assets as compared to industry.
      c) Has strong line of credit.
      d) Has improved debt-to-equity ratio.
      e) Viewed favorably by investors who oversubscribed initial and following stock offerings.

2. Weaknesses
   a) Poor liquidity but improving
   b) Mutual funds control over 35 percent of common stock and this can have an adverse effect on stock price.

E. Research and Development
   Not discussed in case.

F. Operations
   1. Strengths
      a) Hub and spoke innovative and successful. Increasing business has caused cars to languish in freight yards.
      b) Scheduled trains normally provide reliable service to customers.
      c) Right-of-way maintenance permits fast service and reduces probability of accidents.
      d) Has a large well maintained fleet of cars and locomotives.
2. Weaknesses
   a) Light tonnage scheduled trains are dispatched regardless of break-even status.
   b) WC operating at or above capacity on many lines.

G. Human Resources
1. Strengths
   a) Open door policy encourages two-way communication.
   b) Participative leadership style popular with work force.
   c) Benefit packages exceeds that of unionized carriers.
   d) 800 number to President Burkhardt well received.
   e) Training program provides cross-training and opportunities for advancement.
   f) Small train crews greatly lower labor costs.

2. Weaknesses
   a) Wages below union scale by 15 to 20 percent.
   b) Work hours of operating personnel exceed those of comparable union worker.

H. Information System
1. Strength
   a) Verbal, outstanding
   b) Customer Service Center and Transportation Control System permit WC and its customers to have real time information.

2. Weaknesses
   None

Restated Mission and Objectives
A. Mission - current mission remains valid.
B. Objectives - Current objectives are appropriate but should include:
   1. Reduce operating crew average work day by one hour within three months and two hours within six months.
2. Reduce customer complaints by 60 percent in two months and by 95 percent within three months.

Alternative Strategies:

A. No change (Market Penetration/Horizontal Integration)
   1. Pros: Will increase on-line business and gain additional traffic from purchase of other railroads.
   2. Cons: Will tax WC’s capacity to provide outstanding service. Will further irritate operating crews who are averaging 10-11 hour days. If this latter situation is allowed to continue, unionization with loss of flexibility is a possibility.

B. Pause—get house in order during a three to six month period. Resume market penetration/horizontal integration afterwards.
   1. Pros: Will give WC time to add capacity and begin better satisfying customers and operating crews.
   2. Cons: may cause WC to miss chance to gain new customers or take advantage of other rail line purchases.

Recommendation

Adopt a pause strategy.

Implementation

A. Begin hiring and training of more operating personnel.
B. Purchase, lease or rent sufficient railcars and locomotives to satisfy current and six month projected growth in business.
C. Increase expenditures on expanding freight yard capacity and adding double track where appropriate.
D. Increase number of trains.
E. Conduct an information campaign aimed at explaining present and future efforts to satisfy customer and operating crew complaints.
F. Work with potential new or increased business customers to explain pause strategy and how that will enable WC to better serve them in the future.

G. Do not actively pursue other rail line purchases until pause strategy has been completed.

**Evaluation and Control**

A. Closely monitor operating crew attitudes via surveys and one-on-one meetings.

B. Observe service quality to complaining customers to ensure that causes of dissatisfaction are corrected immediately.