WHITE PAPER

# Predictable Surprises in Transportation

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Be scared…or be prepared.

TranzAct Technologies Inc.
Logistics Management Solutions

Performance. Not Promises.

# Predictable Surprises in Transportation

## Significant Rate Increases could be coming. Be scared…or be prepared.

Savvy shippers anticipate changing market conditions and successfully address issues to minimize the impact on their supply chains. For others, they are surprised—even though these events were entirely predictable—and the costs can be significant!

“Predictable Surprises arise out of failures of recognition, prioritization, or mobilization,” according to the authors of the 2003 *Harvard Business Review* article entitled, “Predictable Surprises: The Disasters You Should Have Seen Coming.”[1]

The authors state:

> *“Despite thoughtful managers and robust planning processes, even the best run companies are frequently caught unaware by disastrous events—events that should have been anticipated and prepared for. Such predictable surprises, as we call them, take many forms, from financial scandals to disruptions in operations, from organizational upheavals to product failures. Some result in short-term losses or distractions. Some cause damage that takes years to repair. And some are truly catastrophic.”*

They cite the attacks on the United States on September 11, 2001, as the most egregious and tragic example of a Predictable Surprise. (The FBI, the CIA, and the airlines had numerous fragmented data points, but did not synthesize and share that data, nor effectively analyze and prepare for the threat.)

## Are there Predictable Surprises that will affect your Transportation Costs?

In the fourth quarter of 2013 and the first two quarters of 2014, shippers were *surprised* by tight capacity in the truckload sector. This had a significant impact on corporate supply chains, as shippers saw a sudden spike in their freight rates, delays in getting their freight moved, and an increased reliance on freight brokers to meet their supply chain commitments. In the latter half of 2014 through the first quarter of 2015, many shippers were surprised at how their supply chains were disrupted by the labor stoppages at our nation’s West Coast ports.

Smart shippers understand Predictable Surprises in domestic transportation will occur in the next three years that have the potential to adversely impact their cost of transportation and their ability to get their products to market. Industry Analysts and business and trade journals are highlighting that over the next three years, depending on what happens with the economy (strong vs. slow growth in GDP) shippers could see their motor carrier transportation rates increase by as much as 20-25% based on a toxic combination of factors that are entirely predictable.

Based on experience, we know that even in challenging economic environments, best-in-class shippers have been able to reduce their total annual freight bill and transportation operations costs by as much as 20-25%. They did this by optimizing their transportation spend management program with industry-recognized best practices. That is why it is in your interest to examine your transportation and supply chain processes and identify the savings opportunities implementation of these best practices can deliver.

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1 *Harvard Business Review*, April 2003, “Predictable Surprises: The Disasters You Should Have Seen Coming,” by Michael Watkins and Max H. Bazerman. In 2004, the authors published a book with the same name.

To put this in context, if your company's current transportation spend is $20,000,000 annually and you do nothing with costs increasing 20%, then your annual spend will increase to $24,000,000.

If, however, you manage proactively and implement a best-in-class transportation spend management program that will save 20% of your annual spend, the savings more than offset the increases in cost. (If costs rise to $24M and then 20% savings are applied, the resultant spend is $19.2M—see Figure 1.)

So our questions to you are:

1. Are you willing to address these threats and how they will adversely impact your supply chain?

2. Have you addressed this cost as an organizational priority and budgeted for this increase?

We are passionate in encouraging shippers to understand these threats and take steps to prevent a disaster (significantly higher rates and supply chain disruptions). In this White Paper, we will offer you our prescription for actions you can take to change the practices and processes that drive your transportation costs and thus mitigate this threat.

## The Causes of Rising Rates

As noted earlier, the economic conditions have a significant impact on motor carrier rates. If there is moderate to strong economic growth, shippers could see their domestic transportation rates increase by as much as 20%-25% over the next two to three years due to a combination of related factors: increasing costs of operation for truckers, diminishing trucking capacity, better yield management by the carriers, and the impact of federal legislative and rulemaking proceedings.

Because the current economy is soft, shippers are not seeing these increases immediately. Shippers should act now to avoid a repeat of late 2013 and 2014 as the economy rebounds.

A recent *Wall Street Journal* article[2] summarized some of the truckers' increased cost issues by stating,

2 *Wall Street Journal*, September 23, 2015

### Figure 1: Savings Resulting from *Proactive Transportation Management*

| | Maintain Status Quo | Manage Proactively |
|---|---|---|
| Annual Spend | $20,000,000 | $20,000,000 |
| Increase in Cost | 20% | 20% |
| Decrease from Cost Savings | 0% | 20% |
| **Future Spend** | **$24,000,000** | **$19,200,000** |

### Success Story
### *Greenfield Industries*

*TranzAct conducted a Rapid Assessment of Greenfield Industries' operations and freight spend, then developed a Road Map to enhance Greenfield's transportation management capabilities, to reduce their freight rates, and to increase visibility into all shipments. TranzAct then implemented two solutions that allowed Greenfield to realize a 99.8% utilization of the lowest cost carrier with accompanying freight bill savings between 22% and 30% in the first 6 months.*

*Rating and routing capabilities were extended to Greenfield's purchasing department allowing them to decide both the speed and the cost of inbound shipments. The buyer selected the lowest cost carrier, the quickest delivery, or a blended solution of lowest cost and time, then sent those routing instructions to the vendors. On pick-up, both purchasing and logistics gained notice of what was inbound to plan receiving.*

*"I recommend TranzAct's Rapid Assessment to any and all small- and medium-sized shippers that really want to improve their transportation operations and reduce their costs," states Bobby Densmore, VP of Operations for Greenfield Industries. "TranzAct gave us a no-risk road map to value, then delivered exceptional results.".*

*To read the full Case Study, click here or go to www.tranzact.com.*

*"A recovering U.S. economy is driving record demand for trucking.... But costs are rising, too. The industry is struggling to attract enough new drivers, forcing companies to raise pay or offer sign-on bonuses. New regulations, including rules capping emissions and limiting drivers' hours on the road, are adding to truckers' expenses. Small and midsize trucking companies are finding they are ill-equipped to adapt. Hundreds of these firms have gone out of business in the past two years.... If large numbers of small fleets fail, it can reduce overall capacity enough to raise costs for shippers, analysts say."*

The article identifies two of the key issues that are driving increased costs: driver retention and salaries, and legal and administrative burdens—primarily governmental regulations. According to the *Journal of Commerce*,[3] truckload rates may need to rise as much as 12-18% just to pay for higher driver wages alone.

Even with a soft economy, the three key issues of driver shortages, increasing carrier operational costs, and excessive governmental regulations will impact rates.

The increasingly onerous Hours of Service regulations and the imperative to implement Electronic Logging Devices that replace manual drivers' logs with automatic electronic data collection will diminish available drive time. They both increase costs and reduce capacity. When demand exceeds capacity, those with the capacity seek to maximize their return, implying rates rise and undesirable freight and/or geographies will not be served—or are served at excessive costs. Additionally, the FMCSA has gone on record in stating that, in the future they intend to address: speed limiters on trucks, driver coercion issues, and driver health issues. These are not theoretical or abstract issues; the likelihood that these rules and regulations will occur is entirely predictable.

What is also predictable is that more and more trucking companies will utilize technology to improve yields, operating ratios, and margins. Truckload carriers are aggressively seeking to maximize their asset utilization to increase revenue and profits. Carriers are vigorously applying accessorial charges to any shipper issues that cause delays and incur additional, and unanticipated, costs.

LTL carriers are also aggressively seeking to maximize their asset utilization. LTL carriers' goal is to get their trailers full. They are implementing dimensional and cubic capacity factors and re-classifying freight to ensure better operating ratios. LTL carriers are revising their long-term contracts to employ dynamic pricing[4] to maximize their capacity and yield.

### The Wild Card: *The U.S. Economy*

*TranzAct conducted a Rapid Assessment The mitigant to rising rates could be a substantial slowing of the US economy. Economic conditions affect capacity. With GDP growth of 2% - 2.5%, capacity has been tight and will get worse. With GDP growth of 3% or more, capacity will be extremely tight.*

*Should further slowing occur—and some financial analysts believe we are headed for a recession—then rates will not rise as steeply as we predict. This situation calls for a different course of action.*

*We believe if the recession occurs, you should take advantage of a unique window of opportunity to get favorable rates and lock in capacity for the coming year. Now is the time to conduct a procurement event for both your truckload and LTL freight—and the next three-to-six months is the ideal time to get the best rates.*

*The three key issues exacerbating transportation cost—driver shortages, increasing carrier operational costs, and excessive governmental regulations—remain constant.*

*Regardless of the direction of the economy, our prescription—assessment, economics, and roadmap—will assure your best result.*

3 *Journal of Commerce*, March 26, 2015
4 Employing density-based and dimensional pricing, in addition to weight/distance-based pricing

Properly calculating “cost-to-serve” has become a best practice throughout the carrier community. As LTL carriers concentrate on better quantifying their true cost-to-serve their customers, you can expect them to adjust both their rates and their terms and conditions to reflect these calculations. The resulting rate increases might take multiple different forms: your basic rates could increase, your freight could be reclassified to a higher class, or accessorial charges could be added for services you were not previously billed for.

Carriers have enjoyed a seller’s market for the past two years and this is likely to continue for the foreseeable future—unless the economy becomes unexpectedly soft (less than 2% growth in GDP). Even with a soft economy, the three key issues of driver shortages, increasing carrier operational costs, and excessive governmental regulations will impact rates (see, “The Wild Card: The US Economy!” sidebar).

While rising rates adversely impact your cost-to-serve your customers, the more significant issue could be constrained capacity that causes diminished service to your customers. If your freight is unattractive, at best it gets priced unattractively; more serious is the inability to get it moved at all!

## Recognize, Prioritize, and Mobilize

So what will you do about the threat?

In the same “Predictable Surprises” *Harvard Business Review* article cited earlier, the authors define their prescription for addressing a predictable surprise in business,

> *“Anticipating and avoiding business disasters isn’t just a matter of doing better environmental scanning or contingency planning. It requires a number of steps, from recognizing the threat, to making it a priority in the organization, to actually mobilizing the resources required to stop it. We term this the ‘RPM process’: recognition, prioritization, mobilization. Failure at any of these three stages will leave a company vulnerable to potentially devastating predictable surprises.”*

With all these factors affecting your bottom line, can you afford to be surprised?

As predictable as the causes of these transportation issues are, so is the remedy. As the authors note:

> *“Some threats, of course, are invisible to insiders. To ferret out these potential dangers, companies should use two proven techniques—scenario planning and risk assessment. In scenario planning, a knowledgeable and creative group of people from inside and outside the organization is convened to review company strategies, digest available information on external trends, and identify critical business drivers and potential flash points. (It’s essential to include outsiders in this group as a counterweight to the self-serving biases of employees.) Based on this analysis, the group constructs a plausible set of scenarios for potential surprises that could emerge over, say, the coming two years.”*

Shippers ignore this advice at their own risk. Significant savings go unrealized because optimizing transportation and supply chain processes is not a high priority in many companies. Best-in-class shippers understand that transportation savings can be realized when they commit to making positive changes and implement optimized spend management to control cost increases.

If you still rely on manual transportation processes and you **recognize** the predictable surprise of transportation cost increases and wish to **prioritize** taking positive action for your company, now is the time to **mobilize** to reduce costs and improve service levels across your organization.

## Be a Proactive, Best-in-Class Shipper

We recommend four closely-related "Surprise-Avoidance Initiatives"—practical steps that you can implement to mobilize an effective response.

- First, stay abreast of what is happening in the transportation marketplace and address issues which affect your carriers' cost structures.
- Second, get rid of the transportation silos and implement a holistic Transportation Spend Management program that manages and controls your transportation spend from procurement through payment with a long-term program of continuous improvement.
- Third, develop a vision for what "best-in-class" looks like for your transportation and supply chain areas. Since it is not unusual for a holistic program to require a lengthy implementation process, you must develop an end-state vision and a road map that defines all of the incremental programs to maximize transportation control and effectiveness and to minimize costs.
- Finally, consider the advantages of implementing a Transportation Management System (TMS) that will provide structure, processes and procedures, rules, and guidelines throughout your transportation organization. A proper TMS delivers process control, enforces standards, provides common ways-of-working, and enables recognized best practices.

## Transportation Spend Management

If you are seriously committed to reducing your transportation costs, there is good news. All of the best practices that numerous companies have implemented to optimize transportation management are widely and commonly recognized—with proven success.

Transportation Spend should be connected and managed with a closed-loop "Plan, Execute, Assess" process. This process should connect the five major transportation activities and deliver component savings in each area:[5]

- Procurement - getting the right carriers at the best price; assuring availability and coverage can reduce your annual freight bill from 5%-10%
- Planning - daily optimization of mode and carrier selection that produces the best combination of lowest overall daily freight cost and best customer service (inbound and outbound) can reduce costs by 6%-9%
- Execution Management - centralized command and control that ensures the plan is executed and that corporate rules and guidelines are observed; ensuring visibility and transparency to orders and loads from tender through proof-of-delivery will save 2%-3% from operational costs and rogue spending

5 Note that the savings have broad ranges, based on industry standards observed in numerous case studies. In addition, they are not completely additive, but savings achieved from the first component may diminish the available savings from the next component.

- Settlement - Paying the correct carriers the correct amount and paying only once and then correctly accounting for transportation saves 3%-10% from your annual freight bill
- Analysis - developing Business Intelligence to analyze patterns of service levels, rates, and lanes to identify outliers; overall analysis for continuous improvement enables savings to be increased over time from the previous four component areas

By connecting each component to its successor, the closed-loop process allows an organization to manage better with better information and continuously improve its annual freight bill savings.

# Transportation Management System

With transportation costs rising, service demands increasing, and capacity shrinking, it is more important than ever to have complete command and control of every aspect of your transportation operation. Managing transportation operations locally, and with note pads and spreadsheets, doom an organization to higher costs and service failures. You must control your transportation operations.

In assessing the value of a TMS, examine the most effective components and the savings that can result from that implementation. In a recent white paper by American Shipper, they stated, "TMS lets companies with complex transportation networks manage those networks in more consistent, thoughtful ways, using fewer resources."[6]

While a TMS provides best practices, plus correct and standard ways-of-working across all aspects of transportation, perhaps its most important role is organizational discipline. A TMS will provide structure, processes and procedures, rules, and guidelines throughout your transportation organization. A proper TMS delivers process control, enforces standards, provides common ways-of-working, enables your organization to adopt recognized industry best practices, and becomes an excellent platform for implementing continuous improvement.

> "TMS lets companies with complex transportation networks manage those networks in more consistent, thoughtful ways, using fewer resources."
>
> Eric Johnson in *American Shipper*, October 2015

Many companies manage carrier procurement, rate maintenance, settlement, and payment in disconnected departmental silos. Further, some manage daily planning and execution at the local level. These practices virtually ensure different ways-of-working, rogue spending, process and service failures, and excessive costs. In addition, since transportation historical and spend data resides in different departments, holistic analysis for continuous improvement is impossible.

# Conclusion - The TranzAct Prescription

Anticipating predictable surprises implies that you can develop alternatives for addressing changing conditions and controlling your costs. We will assist you by bringing expertise, experience, and tools to your organization that will allow you to implement an optimum Transportation Spend Management program.

We understand that you want *Economic Value*—and that you want to quantify your opportunity in advance of investing in a new program. Further, when planning to change operations, ways-of-working, and organizations, it is important for you to be able to define a clear path and sequence of events to get from the start to the finish.

We have an elegantly-simple three step methodology to quantify the economic value you will receive from your transportation spend management program. It is a proven methodology that quantifies benefits and

6 "The TMS Effect - Impacts on the Efficiency of Shipper and 3PL Domestic Freight Execution," by Eric Johnson, October, 2015

provides you with a roadmap to realize measured economic value quickly, easily, and with a minimum of effort and risk. We deliver this to you by:

- Conducting a **Rapid Assessment** of your operations - in one day, we bound your business environment and financial opportunity. The Rapid Assessment has two deliverables: an Economic Model and a Roadmap to Savings. We also identify the Best Practices to be implemented to achieve savings.
- Developing the **Economic Model** - defines the magnitude of your opportunity, based on industry standards and our observation of your current state. We identify the key issues, the opportunities (the recommended solution to address the issues), and the value proposition for each component—the productivity improvement, projected annual financial impact, and other benefits.
- Developing the **Roadmap to Savings** - defines the holistic strategy to improve your transportation management function to become best-in-class. We help you develop an end-state vision and the road map that defines all of the incremental programs along the way. We develop a list of implementation steps, sequence, and considerations with recommend alternatives. We employ our Best Practice Library of industry, functional, and transportation best practices. We place emphasis on "Quick Wins"—changes that rapidly deliver value and have minimal organization impact, technology requirements, and cost.

In this rapidly changing world, inefficient supply chains can have a disproportionate impact on the profitability of your business. If your competitors are proactively addressing these transportation issues while your company is forced to react to these events, you can be at a significant competitive disadvantage.

Our prediction about the coming increases in transportation costs is no longer a surprise to you. If you want to take positive action to mitigate the impact of these increases, call us—we stand ready to help you with an assessment, economics, and a roadmap to success!

## About TranzAct Technologies

TranzAct Technologies, Inc. is the leading provider of Transportation Spend Management Solutions and Software. TranzAct delivers state-of-the-art logistics management solutions that enable shippers to anticipate Predictable Surprises so they can plan for, and control, transportation expenditures.

Using TranzAct's suite of services and tools, you will maximize your transportation control and effectiveness, minimize your costs, and improve your services. You will improve your practices and processes, and we'll help you achieve "best-in-class" status for your transportation and supply chain organization.

TranzAct's transportation spend management solutions include: carrier sourcing, pricing, rating, freight audit and payment for all transport modes, Constellation TMS applications, reporting, logistics diagnostics, and continuous business process improvements. We bring established processes and tools to sourcing events including RFP templates, web-based response tools, and standardized carrier and broker contracts.

TranzAct is a practitioner, not a consultant. If you want the best result with minimum effort on your part and in the shortest amount of time, then you want TranzAct. For more information, visit **www.tranzact.com**, call **630.833.0890**, or e-mail us at **solutions@tranzact.com.**

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