Logistics Management Solutions White Paper

The Carriers' View of *Carrier-Friendly*

This White Paper establishes a clear definition of what really matters to your carriers and translates into tangible benefits for you, the shipper.

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The Carriers' View of Carrier-Friendly

Shippers entering into rate negotiations can maximize the benefits of cost effective rates by focusing on the **3P Procurement Model**. These shippers understand that the carriers' rates (or the ***Price***) are impacted by the shipper's ***Practices*** and ***Processes.***

When a shipper issues their Request For Proposal (RFP), they often state their intent to be "Carrier-Friendly." They use this term to imply that their shipping practices and their processes make it easier for a carrier to do business with them, and to underscore their desire to *partner* with their carriers. However, using the word Carrier-Friendly does not necessarily mean that their company is, in reality, Carrier-Friendly.

Carrier-Friendly has almost been over-used in today's transportation marketplace. Various Industry Analysts, Logistics Service Providers, and Software Vendors have employed the term over the past 10 years to describe the best practices that make it easier for carriers to serve their shippers and consequently lower their operating costs - but what do the carriers think of this? Have we really identified all of the best practices, or the *right* best practices, that will lower their operating costs and reduce their operating ratios? Also, are Carrier-Friendly best practices the same for LTL carriers as they are for Truckload carriers?

We believe that the past writings on Carrier-Friendly have been incomplete. First, previously-published works have primarily focused on best practices for Truckload moves. While there is commonality between Truckload and LTL best practices (particularly getting carriers into, and out of, shippers' facilities as quickly and expeditiously as possible), there are also differences. LTL-unique best practices should not be ignored.

Second, previous reports concentrated on day-to-day operations management and how the carriers could serve the shipper. While this is an area rich with potential improvements, it ignores the entire procurement cycle and the important question of how can shippers work with and support their carriers.

TranzAct has negotiated billions of dollars in transportation contracts and has developed tremendous expertise in the transportation sourcing and procurement process. We know that the traditional transportation sourcing and procurement model used by the typical shipper and third party logistics firm is flawed; it fails to deliver the outcome that shippers desire and expect. Enlightened shippers recognize that being Carrier-Friendly starts with a procurement process that establishes the tenor for the entire shipper-carrier relationship. Being Carrier-Friendly also requires a commitment from the shipper to communicate with their carriers and address their input on an ongoing basis.

What's wrong with the traditional process? Despite RFPs that describe the shipper's desire to have a working partnership and collaborative relationship with their carriers, too often, shippers award their business to the carriers that provide the lowest rates. While this focus may deliver immediate cost savings, shippers who want long-term, sustainable savings will utilize the *3P Procurement Model* in negotiations. They adopt this model and recognize that since their company's shipping practices affect their rates, it pays dividends to invest in Carrier-Friendly initiatives and become a "shipper of choice" for motor carriers.

To clarify and validate what it really means to be Carrier-Friendly, and to determine how a company could be a "shipper of choice," we interviewed a cross-section of LTL carriers to determine what practices and processes really made a difference to them in serving their customers. This White Paper provides guidance for shippers who want to know:

- What it means to be a good partner from a carrier's perspective
- How their requirements and practices affect a carrier's cost-to-serve on an ongoing basis
- How an effective partnership with a carrier translates to more cost-effective rates

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This White Paper will document our findings and establish a clearer definition of what really matters to your LTL carriers and how this can translate into tangible benefits for you, the shipper. We will encapsulate the way in which carriers view their shippers and delineate what best practices make the greatest difference to them.

How Do Carriers Look at You?

Carriers commented that the first step in reducing your carrier rate structure starts with how you negotiate with carriers. Are you truly committed to the partnership process and all that entails, or are you really just looking for the cheapest price?

Shippers who are genuinely interested in long term relationships, sustainable advantages, and a proactive partnering process can achieve significant cost reductions by taking an active interest in what drives carriers' costs. In order to determine what you can do as a shipper to influence your rates, it is helpful to understand the basis for those rates.

Cost-to-Serve Analysis and Operating Ratio Determination

Cost-to-Serve analysis (CTS) is now being utilized extensively by motor carriers to determine pricing. CTS is the process of delineating and analyzing all of the activities and costs incurred to service a shipper and collect the shipment revenue, to arrive at a pricing structure. Stated differently, it is the determination of the *total cost of servicing each individual customer at a lane and product level, and at the designated level of service*. Accurate Cost-to-Serve metrics accumulate, and properly allocate, fixed and variable costs. These metrics get included in a carrier's operating ratio (or profitability/loss indicator) for each shipper that a carrier serves.

The operating ratio is extremely important for motor carriers. The operating ratio adds the direct and indirect costs to serve a shipper, then divides the total costs by the revenues to determine account profitability. Carriers want operating ratios below 1 (operating ratios in excess of 1 indicate an unprofitable account). For example, an operating ratio of 1.2 would indicate that the carrier is spending $1.20 in expenses to earn one dollar in revenue. (You will find an example of a carrier's Operating Ratio Worksheet extremely enlightening. Please click here to download a sample of an Operating Ratio Worksheet.)

Today, methods to develop this information have changed. The quality, or depth of information that the carriers use to calculate more accurate operating ratios is significantly better than it has been in the past. Also, more carriers rely more acutely on operating ratio data when making pricing decisions than they have in the past.

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As one carrier executive stated, “Years ago, building market share was a very important factor in our pricing decisions. We were ‘future-focused’ and believed that greater growth in market share would lead to greater profitability. This led to our offering unsustainable pricing, with financial headaches as a result.”

Developing accurate CTS data requires good information generation and management capabilities.[1] Carriers with good CTS data can identify where all costs occur in their network. CTS recognizes that each product/lane/service level combination is different for each customer and, therefore, will have different costs.

What does all this mean for you and your desire for lower rates? Expect more carriers to provide feedback on the overall profitability of your relationship. While not every carrier will share their actual operating ratio data, it is important to note that many carriers will base their pricing decisions on the operating ratio data. Unprofitable relationships will be made profitable, or the carriers will terminate service. Savvy shippers recognize that this focus on CTS pricing and operating ratios will have significant ramifications on how future negotiations are conducted. The key factors in determining the operating ratio include: Transportation Costs, Accessorial Charges, Nodal Costs, and Other Component Costs.

+ Transportation Costs

Carriers want to operate balanced networks. To this end, they solicit hundreds, even thousands of customers and closely analyze where the freight is moving. In the ideal network, there would be a perfect balance between transportation capacity and the demand for that capacity; the carrier would have the same amount of freight moving in both directions for every lane; and that freight would be ready to move, packaged properly, and ideally pre-loaded in a pup or trailer when the carrier arrived, minimizing dwell time at the shippers’ facilities. Practically speaking this doesn’t happen.

Transportation networks have fundamental inefficiencies. The most significant is a geographic imbalance. Certain areas of the country simply do not have enough outbound freight (Florida, North Dakota). If a carrier has “imbalanced lanes” they run the risk that they must run empty, or partially full trailers for significant distances as they move equipment in their network.

It is crucial to understand that LTL carriers focus on having their trailers as fully loaded as possible when they pull away from the terminal. The CEO of one large LTL carrier told us, “Basically, we are selling space. When an airplane leaves the terminal with an empty seat, that empty seat is lost revenue. When a partially loaded trailer leaves the terminal, that is lost revenue. LTL carriers want to do whatever they can to minimize lost revenue.” With the volatile fuel prices and other factors affecting carriers’ profits, having balanced lanes is extremely important for LTL carriers. Contrast this with a shipper’s view that their shipping network tends to be uni-directional. Shipping takes place between points of manufacture or distribution and customer locations. Even when the network of inbound materials is considered, very few shippers can offer carriers a balanced network by themselves. Therefore, carriers do the best they can to balance their lanes -- attempting to find multiple shippers with complementary shipping lanes so that they can efficiently balance their network and minimize empty miles.

When carriers look at your shipping network, they classify your lanes as head-haul, back-haul, or balanced lanes. Head-haul lanes require the carrier to find a back-haul in the closest proximity to the destination to minimize empty miles. Back-haul lanes are ideal for the carrier because they fill empty trailers and help to balance the network. Balanced lanes have approximately the same amount of freight moving in both directions, also providing the carrier with an ideal situation. Head-haul lanes are the most expensive for the carrier. Through fuel surcharges, you reimburse your carriers for fuel when they are hauling a load of your product. But there is no fuel surcharge for empty

[1] Many carriers have acquired sophisticated and standard commercial software products to replace their own in-house-developed costing and profitability software.

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space. When fuel costs rise rapidly, many carriers are not able to raise their rates to their customers fast enough to offset the profit erosion.

+ Accessorial Charges

When addressing accessorial charges, it is important to understand the comment from a carrier who noted, “We are trying to be like the passenger airlines and charge for everything -- checked baggage, better seats, headsets, and drinks.” Accessorial Charges will have an increasingly important impact on a shipper’s freight costs..

Many carriers have been absorbing accessorial charges even when they had specific applications and charges defined in their tariffs and contracts. This tended to inflate the overhead amount and unfairly burden those shippers that did not use those services. Now the carriers are collecting event data and making an effort to charge shippers for every service used.

For example, one LTL carrier told us that they believe they lost the most time and money on residential deliveries. Even though they had a defined accessorial charge for a residential delivery, they were not applying it consistently nor frequently. Under their former model, they allocated stop time by dividing the total stop time by the number of stops. They believe that the residential delivery has three additional cost components:

- “Stem time” from the heart of the route: This roughly translates to the time spent driving out-of-route to reach the residence. This is further exacerbated by the fact that residential deliveries are normally not near commercial deliveries.
- Extra time spent at the stop: Residential deliveries often include some type of inside delivery, step-up, and/or trash removal - all that burdens the driver.
- Liability incurred by entering a residential neighborhood with a large truck

This translates to a stop time 3 times longer than a business delivery. They are doing everything they can to refuse residential deliveries because they feel they cannot recover all of the excess costs.

The key message is -- shippers who require significant accessorial services will experience substantial increases in their freight bills.

+ Nodal Costs

Nodal costs are the costs that occur at specific geographic points in the network -- the pick-up and delivery locations and stop-offs in transit. Also, for LTL carriers, they are the points in the network where the freight is handled (loaded, unloaded, cross-docked).

More sophisticated in-vehicle and driver information systems, combined with increased government regulation, have caused many carriers to accumulate better trip event reporting information. When loaded into a CTS model, the carrier can determine the average stop time for every node in the network that they visit. Some carriers even compare average stop times to standards, compute variance amounts, and adjust the stop time cost component in the CTS model accordingly.

+ Other Component Costs

There are two administrative areas that are added to the cost-to-serve equation -- the cost of billing and collection and an allocation for loss and damage. These can be directly attributed to a specific shipper. Other overhead costs, such as sales and marketing expense, become part of a general overhead expense category that gets allocated within the cost-to-serve model by the appropriate formula (or a specific allocation amount).

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What Does This Mean to You?

In the Cost-to-Serve world, your carriers have much better information about their costs. Given these data, they can determine where they want freight and what types of freight they want. They will become more granular and specific in their rates and with their discounts. Carriers have also told us that some shippers' systems will not accommodate a more detailed matrix pricing, rather they are limited to a base rate and discount for a particular set of attributes. When this occurs, and the shipper's system cannot accommodate the carrier's rate matrix, they "average price" the business to the detriment of the shipper. As opposed to a general base rate and discount, you may see a myriad of different discounts based on the desirability of the business to the carrier. Carriers will provide better pricing for more desirable freight.

Instead of a carrier coming to you saying they think they need a specific percentage increase without support, they may bring you a complete cost worksheet identifying each of their component costs by lane, and potentially, by product and by service level to justify the need.

As with any successful business, carriers must know their costs, seek the type of business they want, refuse the business they don't want, and price accordingly. This does not mean that you cannot negotiate favorable rates, but you must be prepared to work with your carriers to ensure a win-win situation.

How You Can Reduce Your Transportation Costs

Given the carriers' move towards Cost-to-Serve, here is what you can do to materially affect your rates and charges: actively apply the 3P procurement model and carrier friendly principles in your relationships.

In true partnering, both parties are motivated by a win-win mentality. According to most carriers, **too many** shippers practice unilateral negotiations where the emphasis is on the shippers *winning*. The carriers cited the relentless push to cut rates, regardless of the impact on the carriers' profitability. Carriers must maintain profitable operations to survive. Therefore, it is imperative that shippers treat their carrier trading partners well during negotiations to ensure their continued ability to provide service. The number of carrier bankruptcies each year is a testament to the narrow margins under which carriers operate.

If a shipper and their carrier partners are committed to the 3P Procurement model, it is important to share much more information about costs and the overall profitability. There is a real risk for carriers and shippers who focus on only one P -- Price. Carriers will take advantage of market conditions whenever possible and immediately increase rates to make unprofitable relationships profitable, even if it means terminating the relationship! Shippers who continually rate-shop to attempt to beat a carrier's real costs put themselves in jeopardy of being unable to maintain continued service throughout volatile business cycles.

In unilateral negotiating, shippers who rely on the *"can you beat this price"* game will have pricing structures based on true supply and demand market considerations. If the total market volume goes down, discounts will go up; when market tonnage or volume goes up, discounts will go down. What is missing in this approach is the ability to control, or *reduce,* your rate structure over the long-term.

The advantage of the 3P Procurement model is that it encourages an active dialogue between the shipper and carrier about a shipper's requirements and the cost component of the carrier's overall rate structure. Whether you are conducting a comprehensive procurement process, or negotiating rate increases with your existing carrier base, if you want sustained control of your rates, you need to focus on:

- Understanding what your company does that drives your carriers' cost
- Adopting best practices and processes to reduce your carriers' costs

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- Sharing information on an on-going basis
- Making changes whenever possible to become more Carrier-Friendly

If you want a good starting point in working with carriers, consider the following feedback we received from major LTL and TL carriers. We asked, “If shippers were serious about reducing your *costs,* what would they need to do?”

The carriers responded that a carrier's cost structure, or more specifically the carrier's cost-to-serve your account, can be categorized into three broad areas:

- Pick Up and Delivery - is the carrier delayed for any reason at your facility, at your customers, or at your suppliers and can you reduce the number of pick-ups or deliveries (can multiple shipments be made available at one time)?
- Operation - is your freight packaged properly, easy to handle, and not susceptible to damage?
- Administration - do you pay freight bills on time, communicate electronically with the carrier, and provide each carrier sufficient volume?

If you want to *reduce your rates*, see what your company can do to *reduce the carrier's costs.* The Bottom Line: If you can reduce your carrier's cost of doing business, the carrier should translate that into lower rates for your company.

Does this Approach Really Work?

If you want the best possible rates from your LTL (and Truckload) carriers, you should focus on the 3P’s - Pricing, Practices, and Processes. Since a commitment to the 3P model can require more data and take more time to analyze, you might ask, “Is it worth it?”

Based on our extensive experience, we say “YES!” We know that shippers who commit to the 3P model will achieve better results from their transportation procurements. We offer three examples that attest to the merits of the 3P model.

+ Case 1

A company with a $55M annual LTL spend was concerned about proposed increases of between 6% and 8%. They retained TranzAct to conduct a benchmark analysis of their rate structures. We verified that they had very good LTL rates and an aggressive schedule for accessorial charges. Instead of accepting the proposed rate increases or relying on the traditional negotiation model to scale back the proposed increases, they retained us to conduct an LTL Bid on their behalf. They projected that if their actual LTL rate increases were 2% or less, their negotiation would be successful. By utilizing the 3P model, actively highlighting this company’s Carrier-Friendly best practices, and demonstrating the value of their business to the LTL carriers, this company actually lowered their rates by 6%!

+ Case 2

A company with an annual LTL spend of $1M was concerned that increases in their freight costs would affect their competitive position and cause them to lose important sales opportunities. They retained TranzAct to analyze their LTL network and identify opportunities to change practices and improve their logistics processes before conducting a procurement. We identified savings opportunities, including the creation of a corporate call center and the implementation of a load consolidation program that dramatically lowered their outbound freight costs. After implementing these process and practice recommendations, we rebid their freight and reduced their freight costs by 10%!

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+ Case 3

A company with an annual LTL spend of approximately $11M wanted to conduct an LTL Bid, but was uncertain if they should outsource this process, or conduct the bid in-house. They solicited proposals and in response, TranzAct benchmarked their rates and determined that a savings of approximately 8% to 9% was obtainable. After soliciting proposals, they decided to conduct the bid themselves and were satisfied that they had achieved a savings of 3½%. At an annual logistics industry conference, an executive with this company described the process they used to solicit bids and award business. They focused just on Price, instead of employing the 3P model. Knowing the accuracy of our benchmarking model, we conclude that this company left an additional 4½ to 5½% savings on the table!

Conclusion

We can cite hundreds of other cases that highlight the benefits of utilizing the 3P Procurement model in the transportation sourcing and procurement process. The 3P Procurement model provides you with the opportunity to work collaboratively with your carriers to manage the costs that a carrier incurs servicing your business. A company that is truly Carrier-Friendly will achieve lower rates and better service from their carriers!

If you are interested in learning more about how your company can be a Carrier-Friendly shipper, we encourage you to give TranzAct a call. We welcome the opportunity to share our expertise and information about the 3P Procurement model, and how you can be a Carrier-Friendly shipper.

About TranzAct

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 plan and control transportation expenditures. TranzAct also helps shippers improve practices by providing the tools necessary to remain in control. Our solutions provide shippers of all modes with freight audit and payment, reporting and TMS applications, carrier sourcing and pricing, and logistics diagnostics and business process improvements. For more information, or to speak with a transportation guidance expert at TranzAct, please call 630-833-0890 or visit tranzact.com.

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