

Recession Busters – Five Steps for Small Parcel Savings – Now

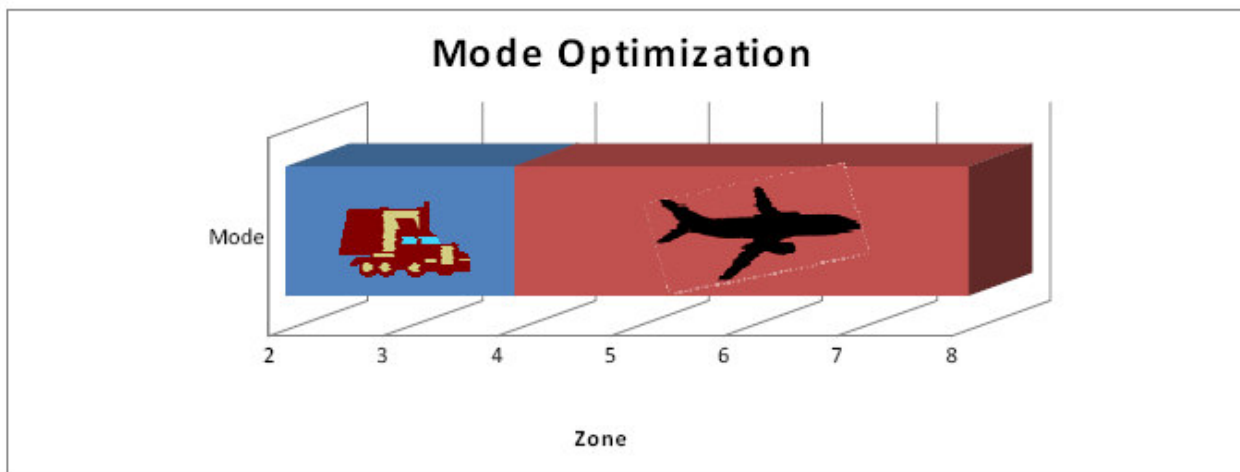
Recession Busters – Five Steps for Small Parcel Savings – Now – By Melissa Priest & Dan Romo

With the U.S. economy in a deep recession and unprecedented challenges ahead for many industries and businesses, it is becoming more critical, and more difficult, for companies to find new ways to cut costs and increase profits. As we have seen demonstrated by layoffs and benefit reductions through February 2009, many businesses are in trouble and many large shippers have seen their sales decrease by 20-40% since October 2008. In addition to the decreases in sales, which have substantially impacted shipping volumes and left many retailers scrambling for survival, there have also been changes within the small parcel industry that will significantly impact shippers. DHL has left the marketplace, economic bellwethers UPS and FedEx are very strategically determining how to manage costs, and the USPS is changing how it operates in the marketplace.

Given this dynamic set of circumstances, it is critical to know where businesses can look to strategically and successfully identify and capture small parcel savings.

1. Mode Optimization

Over the years, carriers have spent millions of dollars conditioning our thinking to “absolutely positively overnight.” A simple way to quickly reduce cost is obvious. Do not use “next morning” when “next afternoon” will suffice. Do not use two-day when three-day will do, etc. As a company, thought must be given to the contents of the package, to whom it is being and when it absolutely needs to be delivered. If priority services are needed, management approval should be required. The more difficult it is to secure approval for priority shipping, the more employees might just default to using the more cost effective options. Many businesses benefit from a disciplined, analytically driven cost reduction approach. Of course, while express offers day- and time-definite guarantees versus ground’s day-definite delivery, many are finding significant savings by opting for ground delivery instead of express in certain circumstances. ABC Company has a small parcel spend of \$4.3 million with a cost per package of \$15.67. The “overnight” geographic distribution breaks down as follows:



Zones

2	3	4
11%	7%	10%



Zones

5	6	7	8
21%	24%	18%	9%



A significant number of packages were being shipped to zones 2 through 4 when carriers can reach most of these destinations next day via ground service. In fact, many short haul air shipments are currently being moved via truck. The benefit is obvious. Taking packages off a plane and putting it on a truck significantly lowers cost. ABC Company's express pricing averaged \$25.45 per package while their ground service costs were \$7.53 per package. A corporate decision was made to ensure no express shipping where ground could provide comparable delivery times.

All shipments in zones 2 and 3 would go via ground service. They would verify zip code pairings in zone 4 to determine guaranteed delivery times.

The result was a converting of 28% of their "overnight" packages to ground, and a reduction of over \$15 per package on tens of thousands of shipments. The same exercise was done for all packages sent via 2-day and 3-day delivery to zones 2-4. This was a dramatic reduction without sacrificing service levels.

Be aware of each of the carriers' offerings that may present other opportunities to reduce cost. For example, UPS has revived UPS Basic, a contracted residential service for 1-5 lb packages. UPS Basic provides UPS pick up and delivery to nearest USPS DDU for final mile delivery. It reduces costs while providing package visibility during transit via UPS tracking and USPS delivery confirmation. Each of the carriers has a wide range of cost effective alternatives tailored to meet the needs of specific segments of your business.

2. Understand the Marketplace –

The carriers are not immune from the economic downturn. They, too, have been seriously impacted. Thus, negotiating for better pricing has become more difficult--but not impossible.

With package volumes on the decline, carriers are more reluctant to participate in RFPs. Protecting margin is the order of the day.

Mode Optimization

The 2009 general rate increase was the largest ever, especially in ground service. It is important to understand how the rate increase specifically impacts your business. A couple of items of note:

- While fuel prices have dropped dramatically, the carriers practice of raising their rates and then allowing a 2% rollback on fuel has served them well. In the last three years, it has allowed the carriers to “bake” an additional 6% into the base rates.

- Then there are the dreaded add-on fees. Surcharges for fuel, residential, address corrections, oversize (dim), Saturday delivery, Saturday pick-up, declared value, no account number. Aside from the 85+ plus accessorial fees (200+if you add international) there is a new wrinkle for 2009, “Extended DAS.” In 2008, DAS (Delivery Area Surcharge) included 23,462 zip codes (out of the 42,728 zip codes in the US). Aside from an increase in the DAS surcharge, UPS has now introduced Extended DAS, which applies to 82% of the DAS zip codes for 2009. The impact? An additional cost of \$0.25 in addition to the standard DAS surcharge. If you ship an express package via UPS to a residence with a zip code on the Extended DAS list you will incur surcharges of \$5.05 plus the package charge, plus the fuel surcharge, etc.

Remember, while the announced rate increase was 6.9% with a 2% rollback on fuel, it is only an average. The carriers have very sophisticated “cost to serve” pricing models. Thus, the “favorable” package shippers have seen modest annual increases while the “less favorable” package shippers (residential) have seen double digit increases. Request an impact report from your carrier to determine the specific increase for your company.

If you are a heavy postal user just remember in 2008 USPS began offering volume-related price incentives for Express Mail, Priority Mail and other shipping services allowing them to better compete in the small parcel market. Postal shippers can take advantage of commercial volume pricing, minimum volume rebates, online pricing breaks and other pricing incentives.

Each and every segment of your transportation spend must be analyzed for areas of improvement. That is why understanding your shipping data is vital. While putting your company’s transportation out to bid via a formal RFP allows carriers to compete for your business, it is no longer enough to pit them against one another to maximize on savings and extract cost. It is imperative to understand your shipping characteristics in order to prepare to engage a carrier in negotiations.

3. Consider the Economy and Target Tiers – An Economic Double Whammy –

Over the past several years, UPS and FedEx have fundamentally changed the way they offer discounts to their customers. Instead of giving discounts by service, regardless of the level of spend, they now peg some, or all, of the discounts to tiers that are based upon the rolling average of a customer’s weekly gross spend.

There can be several different tiers, each representing a range into which that rolling average can fall. Each tier has a different incentive tied to it. The carriers tie the rolling average to revenue tiers in order to manage a number of dynamic situations. If a customer’s revenue is growing, and the rolling average is growing, there are often higher tiers of incentives built into the agreement that will yield greater incentives in return for the greater revenue. This rewards the customer without having to renegotiate the agreement.

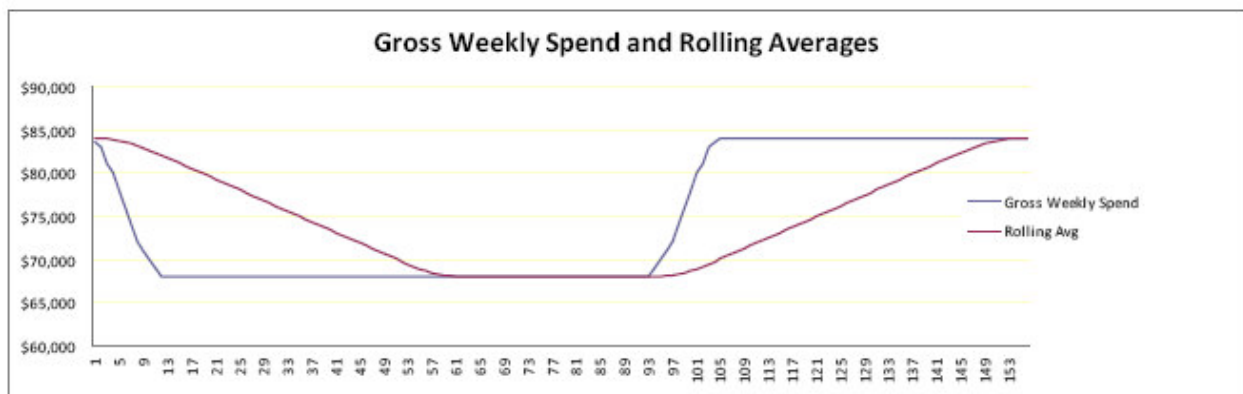
On the flip side, if a customer’s revenue falls due to economic conditions or a shift in the business, a lower rolling average can yield a lower incentive if the rolling average falls into a lower tier. The tier system, therefore, allows for some fluctuation in business without a renegotiation of the agreement and is somewhat self-correcting.

Rolling averages are typically set on a 13- or 52-week basis and, if used correctly, can insulate a shipper from dips in business due to seasonality. Additionally, many agreements are structured so that there is a target tier in which revenue is anticipated to fall. If revenue climbs, incentives climb. However, if the rolling average falls below the target tier, the incentives drop, which will negatively, and often significantly, impact your net effective discounts. However, the economy is in uncharted territory and a situation

analogous to the mortgage rate reset is coming to a head. Many shippers have seen sales plunge by 30% in the past several months. This, in turn, has caused a dramatic reduction in shipping volume and in gross weekly revenue from these shippers. Many of these companies have a 52-week rolling average, whereby the oldest week drops off each week and a new week gets added in and the new total is divided by 52 weeks. In this manner, the rolling average can hide a precipitous drop in business, often for some time. The catch is that when the gross weekly revenue finally does impact the rolling average, the results can be dramatic and difficult to recover from, as demonstrated in the following example:

ABC Company gives all of their business to Carrier X, which averages approximately \$84K in gross weekly revenue. Company growth has been flat and the company has been achieving the incentives in their target tier of \$80K-\$90K in gross weekly revenue. However, ABC Company, as shown in the summary below, was hit hard by the economic downturn, and only had \$68K in gross weekly revenue for nearly 19 weeks, from October 2008- February 2009.

ABC Company was unaware of the impact and fell off of their target tier after 19 weeks of falling gross weekly revenue. If ABC Company does not take immediate action, it may take ABC Company 34 weeks at \$84K in gross weekly revenue to get back to their existing target tier. If for example, ABC Company lost 12% of their incentives when they fell off their target tier, and stayed at the lower tier for 53 weeks, the increased cost to the company would be \$534,240. This is an economic hit twice over – first with dropping sales, then with higher costs.



While companies are still giving most or all of their business to one shipper, which is the intent of the tier structure, some companies are in imminent danger of losing a substantial portion of their discounts. This is an unintended consequence of the economic environment and one that shippers should very carefully analyze in order to avoid a potentially dramatic economic hardship. If a shipper finds themselves in the danger zone, it is critical they meet with their carrier and try to negotiate a solution that will mitigate the impact.

4. Know Your Strategy:

In this time of contraction for both the small parcel carriers and business alike, it is more critical than ever to know what you are seeking to get out of your negotiation. As mentioned above, it is key to negotiate in the areas that drive the biggest ROI. However, it is also important to determine how to get the carriers excited about your business and if you will benefit from bundling various modes of transport with the carriers.

A successful negotiation comes when all parties involved have a win they can walk away with. Often times, however, shippers can look at a parcel negotiation from a win-lose standpoint. This is unfortunate, as the road to a successful outcome can be made much smoother with minimal effort. By sharing corporate goals and providing a strong business case for certain concessions, it will ease the job the carrier sales representative has to do internally. The better the sales person can articulate the business need of the customer, the more likely a positive outcome.

Also consider if UPS or FedEx will gain new business or only dilute existing revenue. It works to the shipper's advantage to have new business to offer when asking for additional discounts. This does not necessitate a sole source environment, only that there is upside potential for the carrier. The additional source of new revenue for the carriers might also come from freight, international or ocean business that has not previously been considered. These types of additional business can open the door for improved savings and a better negotiation.

5. Carefully Consider Bundling:

Both UPS and FedEx provide air freight, ocean freight and a myriad of international distribution services. Many shippers are unaware of the strength of FedEx and UPS in these different areas and, therefore, do not include the carriers when negotiating these modes. Failing to understand what the carriers bring to the table leaves the opportunity to bundle business unexplored and potentially unutilized. Bundling, or the combining of different modes of transport into a single negotiation, can work for or against a shipper. As such, it is important to have a solid understanding of the risks and rewards.

The first step is to determine your own internal business needs, followed by an assessment of what mode specific challenges and opportunities are. Considering multiple modes at once, as well as what the existing service providers offer and what benefits can be gained, should provide the answer as to which direction to follow. Also bear in mind that this answer can change, so the question of bundling should be asked and re-asked on a regular basis.

Analysts estimate that from about 10% to 26% of all retailers are in financial distress and in danger of filing for Chapter 11 in 2009 or 2010. These are sobering numbers which underscore the importance of a strategic approach to cost cutting. Reductions with regard to transportation costs, which typically average 3-15% of gross sales, can directly and significantly impact the bottom line. The impact to the bottom line can, in turn, help to safeguard jobs and employee benefits. By focusing on some or all of these opportunities, the business re-enforced, protected and re-invigorated can be your own.

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