

Understanding Carrier Behavior in a Dynamic Parcel Climate

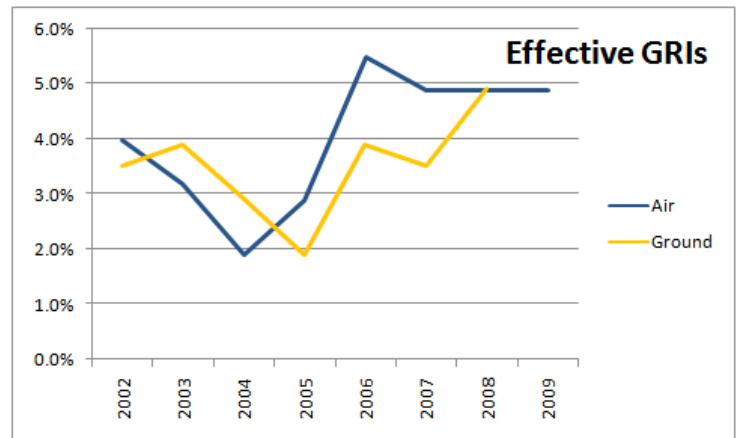
The Carrier Experience:

It should come as no surprise that parcel carrier volumes are down. With retail sales down from 5% to 20% year over year, and with new manufacturing orders at their lowest levels since 1980¹ it is clear that there are fewer packages in the parcel channel. Just like retailers and manufacturers, parcel carriers depend on volume for their revenues. As a result, parcel carriers are feeling the economic squeeze as much as, or more than, anyone else. With DHL leaving the domestic US market, UPS and FedEx can expect some volume spillover, but these volumes are unlikely to offset the overall decline.

What does this mean to you, the shipper? Plenty! As I've mentioned many times before, carriers are like any other business entity. Their behavior is driven by their environment and the actions available to them. This means that, to a point, their overall strategies are predictable. Let's look at some of the areas where declining package volumes may have an impact:

Pricing Negotiations:

The 2008 Parcel Annual Best Practices Survey suggests that carriers have been more aggressive in negotiating contracts over the past year; scoring 6.3 on Parcel Magazine's scale in 2008 vs. 4.5 in 2007². This impression matches our projections and our experience over the past twelve months. However, the playing field has changed. Once the grab for the DHL business has passed (likely by the end of 1Q09), the overall competitiveness of the market will decline. Combine this with the yield pressures coming from the declining economy and carriers are likely to become more conservative in negotiating discounts. This does not mean that savings opportunities will disappear. It does mean that you need to approach a negotiation in a well-planned, logical way. It also means that detailed qualitative analysis should be applied to



proffered programs to determine the bottom line impacts and to ensure that the proposals aren't just "smoke and mirrors".

Rate Increases:

As we accurately predicted in early 2008 the 2009 general rate increases (GRI) are coming in higher than recent averages. While some argued that a sliding economy would not allow for aggressive GRIs, higher discounts and falling yields have put the carriers in a position where higher GRIs are almost an absolute necessity. Even if the economy turns around in CY08, discounts have grown and yields have contracted to the point that we project higher than average GRIs for at least the next two years. It is important to note that a 4.9% GRI doesn't mean 4.9% for everyone. The GRI is not a static increase; different services, weights, and zones receive varying levels of increase. For example, FedEx's Priority Overnight Package rates are increasing by 5.7% in 2009 (adjusted for the decreased FSC index), while the 3-Day service (Express Saver) is increasing only 2.6%. Once again quantitative analysis is the answer. Applying the actual rate schedules to your specific package distribution is the only way to get a handle on the cost increases you can expect.

Service Guarantees:

FedEx made a splash with their tagline, "When it absolutely, positively has to be there overnight." This simple phrase is arguably one of the most memorable pieces of marketing copy ever written; right up there with "Where's the beef?" and "Can you hear me now?" To reinforce the confidence in their service the carriers offered guarantees. If the package didn't get to its destination on time, you received a refund. But once again, times have changed.

For some time the parcel carriers have been stepping back from service guarantees. While carriers still want you to have confidence in their ability to deliver your packages on time, they are no longer willing to back that confidence up with dollars; at least not to the point they have in the past. There have always been restrictions on guaranteed service. For example, residential packages that were originally shipped as commercial are not eligible for refunds, nor are incorrectly addressed packages. Also, claims filed more than 15 days after the invoice date are not honored.

However, several new changes have been made to the carriers' guaranteed service policies. In August 2008 UPS announced that fuel surcharges would no longer be eligible for service guarantee refunds. UPS justified the move by saying, "... since we still make the delivery, including fueling the truck to get it there, we are going to stop refunding the fuel surcharge fee."³ This argument is specious at best. From our perspective, the same argument could (and may later) be made concerning any portion of the parcel charge. What's next, the residential surcharge, the delivery area surcharge, the transportation charge itself? In our view this is nothing more than a parcel carrier using higher fuel prices to justify an unpopular corporate goal. UPS has recently suspended GSRs for remote zips, suggesting that they can deliver packages on time, but not if you have to drive very far to get to the destination. Worse still, we have been unable

to obtain a list of the zip codes impacted by this change. Finally, UPS recently extended the "No Service Guarantee" range for the 2008 holiday season from 14 days prior to Christmas to all of December. All of these changes demonstrate a reduced commitment to quality service, and should reinforce the importance of asserting your remaining rights. Enlisting the services of a qualified parcel auditing firm is a good first step. Also, whether you negotiate your next parcel agreement, or whether you enlist a third party to negotiate it, make certain you do not waive your right to file service guarantee claims. Carriers have started including a guarantee waiver in nearly every proposed agreement. These waivers are not usually mentioned by the carriers, so be vigilant to protect your interests.

The Takeaway:

Today's economy is tough on everyone. It will continue to be so, at least in the short-term. It is understandable that the carriers will attempt to insulate their revenues and margins from the current market conditions. However, it should not be at your, or your customers', expense. Reducing service and increasing cost is not a long-term solution, nor should it be acceptable to you, the customer. As we continue through this economic downturn don't ignore the impact of your transportation costs. Vigilance on your part can mean bottom-line savings that will help your organization weather the storm.

-
1. November 2008 Manufacturing ISM Report On Business, institute for Supply Chain Management, December 1, 2008.
 2. Parcel Shippers Make Moves to Offset Economic Forces, October 2008, Marll Thiede, pg. 14
 3. UPS Won't Refund Surcharge, Traffic World, August 28, 2008