

Freight Term Optimization

Reduce costs and increase margins by managing the right freight.

What is Freight Term Optimization?

We all know that moving the freight right reduces transportation cost, but sometimes overlooked is the value of moving the right freight. Freight Term Optimization (FTO) is the process by which shippers strategically establish the most advantageous freight terms, minimizing total inbound landed cost and maximizing margins on product shipped outbound. The optimal freight term is influenced by a shipper's ability to consolidate orders across days and shipments across vendors/customers, order-level service requirements, and as well as the shipper's ability to plan and execute routing options like multi-stop TL, static or dynamic pooling, zone skipping, triangle routes, backhauls, etc.

In order to correctly manage FTO, one needs to analyze a vendor inbound move or customer outbound move in the context of other relevant typical shipments, not just as stand-alone moves. This is difficult to do without the right tools and actual or achievable benchmark transportation rates. FTO on inbound moves is even more difficult if transportation managers do not have cooperation and support from the purchasing function and key buyers. And, since inbound transportation managers have historically had little visibility into their

company's purchase orders and even less visibility into supplier shipping intentions, prior attempts to control inbound freight may not have earned cooperation and support from the purchasing function and key buyers.

Because of these difficulties, many shippers do not effectively manage FTO, and as a result, they pay a hidden freight cost; either by paying too much for goods that could have a lower landed cost if the inbound transportation move were controlled, or by charging too little for product that could be delivered less expensively than if a customer were to pick it up. Frankly, what is sometimes called "free freight" on the inbound side actually often represents a company's most expensive move! Perhaps one should only ship "free freight" after they return from that famously non-existent "free lunch."

Which entity should control a move is a matter of numbers, not philosophy, and not always a question of which entity is larger or has more market power. Moves should be controlled by the entity that can provide them the least expensive option, while meeting the combined service requirements. And, while the larger entity or the entity with greater transportation spend often has lower



transportation costs, we have definitely seen moves that could be provided less expensively by the smaller or lower spend entity. This is often because of triangle moves or backhauls the entity is able to capture if they control the move.

The Freight Term Optimization Process

Timing

Most companies establish freight terms when they gain a new customer or sign up a new supplier. This is established on the basis of shipment volume with customer or suppliers only (or make only a cursory attempt to estimate interaction with other shipment volumes), and they revisit those freight terms infrequently and irregularly. However, FTO analysis should be done on an annual or bi-annual basis.

To support and enable annual FTO analysis, companies must develop good sources of shipment information on loads they do not control (like EDI 856 data on inbound prepaid shipments or DC reports on collect outbound shipments), develop a good freight term negotiating process, and ensure that freight term conversion implementation SOP's are well documented. Transportation management organizations that are supported and enabled by a well-implemented TMS can

more easily accomplish FTO because they have an application to receive and act on data about prepaid inbound and collect outbound loads. These organizations should be making daily tactical use of an optimizer that can be used for FTO analyses but regular, periodic FTO efforts are highly valuable, even for more manual operations.

Analyzing Freight Costs

The first step in the FTO process is to determine the transportation cost of controlling a customer's or a supplier's moves. This cost will later inform the negotiation process with suppliers or customers. It is important to understand that the cost of controlling a customer's or a supplier's moves is not simply the cost of the moves themselves, but the difference between the total solution cost with and without the customer's or supplier's moves. The moves for most suppliers and customers do not affect the overall solution structure, but some do, either by changing pool consolidation or pool distribution economics, altering multi-stop TL routing opportunities, or eliminating backhaul, continuous move, or triangle route opportunities. And while high volume customers or suppliers, particularly those with geographically concentrated moves, are much more likely to affect the overall solution structure,

FTO analysis often uncovers lower volume customers and suppliers whose moves are disproportionately important.

Key elements in determining the cost of controlling a customer's or a supplier's moves include:

- A representative data set of loads to be moved
 - Summarized demand at a 3-digit zip code level will not work
- The data set needs to be at a shipment or load level and reflect real or representative time-phased demand (i.e. shipment or loads are particular days, not just within a monthly or quarterly period)
 - TMS or freight pay systems typically provide good data on currently controlled moves
 - Data on moves that are not currently controlled is more difficult to obtain, but a well-implemented TMS may be used to provide visibility on inbound prepaid moves
- Dock scheduling systems may also have information on inbound prepaid moves, and most WMS systems can provide information on collect outbound moves
 - These data sets may have to be "cleaned" so as to reflect expectation of future move volumes
- Multiple scenarios are often needed to reflect expectations about new

or lost customers, changed supplier relationships, facility closure, or other changes

- Actual or achievable benchmark rates to use in the analysis
 - Current contract rates are the starting point
 - Achievable benchmark rates are needed when prepaid moves are on lanes for which no current contracted rates are available and for any non-current pool location
 - Scenarios should be run with rates that estimate the effect of increases or decreases in move volume, particularly if private or dedicated fleet is a routing option
 - Sensitivity analysis can and should also be run with rates that incorporate expectations about general rate increase or decrease expectations
- An optimizer with robust analysis functionality with the ability to:
 - Evaluate changes to pickup and delivery windows within the application rather than requiring manipulation of available and delivery dates in the actual data set
 - Consolidate orders across days and shipments across customers or suppliers
 - Analyze routing options like multi-stop TL, static or dynamic pooling, zone skipping, continuous moves, triangle routes, backhauls, etc.

Customer or Supplier Negotiation

The second step in the FTO process is using the transportation cost of controlling a customer's or supplier's moves to negotiate prices with them that reflect possible change in control of the moves. The sales group or the purchasing/procurement group will typically drive this portion of the FTO effort; however, they almost always need support from transportation professionals to address customer or supplier objections and evaluate customer or supplier pricing offers. It is very common for initial supplier freight allowances to be unrealistically low. It is also very common for customers to expect to receive all of the cost reduction benefits in return for continued business rather than any increase in margin.

Organizational incentives often need to be aligned to encourage and reward the sales or purchasing groups to capture these savings. Otherwise, these groups may negotiate away this freight term opportunity at too low a value in return for benefits that are more common in their historic negotiation process, or for a benefit that flows directly to their group/function. Fortunately, most procurement organizations that are not negotiating on the basis of total landed costs are trying to move that way. Some salespeople

may be willing to negotiate margin; there is almost always some powerful organizational owner of margin rates. So, while transportation professionals that drive corporate improvement through FTO will likely need to cultivate allies in other parts of the organization, those allies almost always exist. Allies almost always appreciate having transportation functional leaders understand and frame transportation's functional role in the context of larger financial issues like total landed costs and sales margins.

Implementing the Conversion Process

The last step in the FTO process is capturing the savings. Implementation will differ depending on whether a company's transportation operations are enabled by a TMS or are more manual. TMS-enabled transportation management typically generates more savings and it is easier to convert freight terms in TMS-enabled operations.

Regardless of whether current operations are TMS-enabled or not, it is important for the following:

- The operational conversion process should be well documented and must be able to be executed without disrupting freight flows

- Transportation costs must be tracked against estimates for the converted customers or supplier so that the decision can be validated and the savings can be taken credit for!

In Conclusion

Freight term optimization is a structured process that ensures you are managing the right freight; the freight most valuable for you to manage. This is accomplished by analyzing data on all moves, using current and forecasted carrier rates and using an optimizer capable of analyzing savings opportunities from order-level consolidation to complex routing.

The key benefits of FTO are cost savings or margin improvement. Other benefits include building organizational awareness and support of the transportation function. In conjunction with other efforts focused on moving the freight right, FTO improves control of and visibility to both collect and prepaid loads. If your company would benefit from near-term transportation savings and increased control and visibility, exploring Freight Term Optimization would be a worthwhile, strategic initiative.

To discuss how a Freight Term Optimization effort can benefit your company, how leading TMS systems enable transportation savings, or how these services and savings can be accelerated through a transitional or ongoing Freight Management relationship, please contact Stephen Craig, Managing Partner with enVista.

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