

Viewpoint

Fuel Surcharge

What you Need to Know

Introduction

In 2006 FedEx incurred \$3,256,000,000 in fuel costs. In the same year UPS incurred \$2,655,000,000 in fuel costs. That is a combined fuel cost for two of the top three parcel carriers of nearly 6 billion. To put this into perspective, the UPS and FedEx fuel costs for 2006 equated to 90 percent of the Gross Domestic Product of the Bahamas. As carriers have become more sophisticated at tying costs to revenues all three of the primary parcel carriers have included a fuel component to their pricing structures by way of a fuel surcharge. Fuel charges have risen sharply over the past several years, these charges have become an increasingly important cost driver for most shippers. Surcharge levels, how they are determined, and how they are applied vary from carrier to carrier. This article will serve as a primer on the methodologies of the carriers. These methodologies are subject to change over time.

Rate Calculation

Fuel Surcharges are tied to the National U.S. Average On Highway Diesel Fuel Prices reported by the U.S. Department of Energy (D.O.E.) on Ground services and to United States Gulf Coast (USGC) Jet Fuel Price for Air services. All three carriers use a table to index their Ground surcharges to this figure. However, the tables vary from carrier to carrier, resulting in higher charges, on average, for DHL. The rates are set on a (roughly) monthly basis. The rates from the tables are applied to the two-month-ago D.O.E. figures to determine the monthly rate.

Charge Application

All carriers apply the Fuel Surcharge rate to the net, or discounted, transportation charges plus certain accessorial charges and surcharges. The charges to which the FSC rates are applied, again, vary from carrier to carrier. Generally these charges are associated with distant or widely separated pickups or deliveries.

Example:

A twenty pound Overnight package is shipped UPS from Bangor, ME to Fresno, CA (zone 8). The package is invoiced on October 3, 2007. The package is a residential delivery and due to the size qualifies as large/oversize. For illustration purposes we will assume the package receives a 10 percent discount:

$$\begin{aligned} & ((\text{List Rate} - \text{Discount}) + (\text{Resi Surcharge}) \\ & + (\text{Large Package Surcharge})) \times \text{FSC Rate} \\ & ((\$92.60 - \$9.26) + (\$2.20) + (\$40.00)) \times 14.0\% = \$17.58 \end{aligned}$$

The Fuel Surcharge applies to the discounted transportation charges, the residential surcharge, and the Large Package Surcharge. As the transportation and surcharge costs increase, so does the fuel surcharge. The good news here is that negotiating discounts on transportation charges and concessions on surcharges has a positive effect on the fuel surcharge as well.

Fuel Surcharges and General Rate Increases

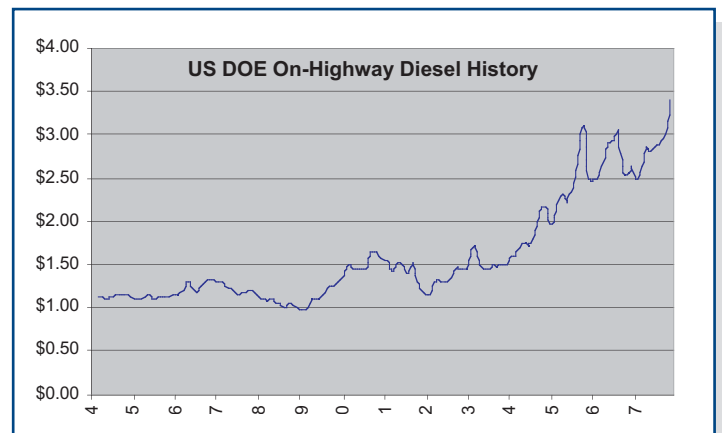
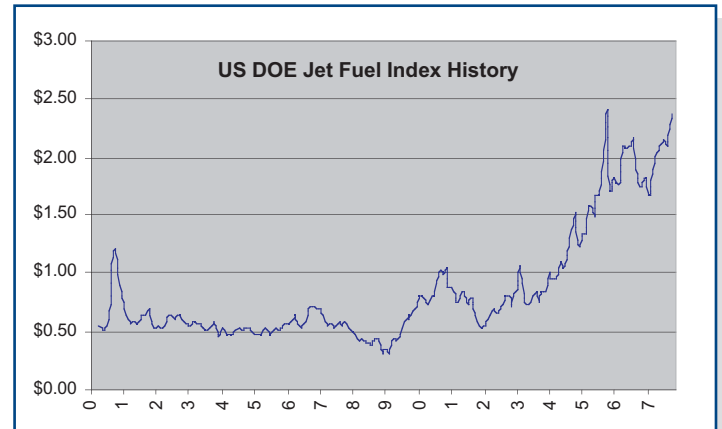
Over the past two years carriers have recognized the rising impact of fuel surcharges on shippers' parcel costs. More importantly they have recognized the impact of rising fuel surcharges of the perception of shippers. As a result carriers

have taken steps to reduce realized fuel surcharges, while maintaining overall package yields. They have done this through the annual general rate increases. Each January carriers make adjustments to list transportation charges, surcharges, accessorial charges, etc. to adjust for inflation and shifting costs. Both UPS and FedEx have adjusted their list rates to a greater degree each of the last two years, and at the same time made a corresponding reduction of the fuel surcharge. For example FedEx announced a Ground list rate increase of 6.9 percent for 2008 in early October 2007. However, FedEx has been promoting the increase as an effective increase of 4.9 percent, as they will be reducing their Ground FSC Index rates by 2 percent at the same time. While the logic makes sense, the reality is somewhat misleading. This action essentially hides the impact of the fuel surcharge. FedEx (and UPS as well) will realize the 4.9 percent effective list rate increase. They will also retain their fuel surcharge revenues, although 2 percent of the current FSC will be “baked in” to the 6.9 percent actual list rate increase.

A Historical Perspective

As we said earlier, fuel costs have always been an important cost driver for the parcel carriers. However, in recent years the impact of fuel on the parcel carriers has grown incrementally. As can be seen below the cost of jet fuel and diesel rose 70.5 percent and 56.5 percent respectively from August 2004 to August 2007. By tying the fuel surcharge to these indices the increasing cost of fuel is largely passed on to the shipper. While carriers reduce the FSC table rates, we have already seen that these costs are still transferred in the form of higher transportation rates. The United States Department of Energy expects oil (and therefore diesel and jet fuel) to remain, “high and volatile”.

With fuel prices high and rising we must reasonably anticipate the role of fuel surcharges to become increasingly important as a cost driver of parcel shipping costs.



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