

Revenue-Based Incentives

Most parcel agreements signed over the past ten years contain some form of revenue-based incentives. UPS calls them Portfolio Tier Incentives. FedEx calls them Earned Discounts. Whatever they are called the concept is the same; incentives are at least partially dependent on how much you spend with the carrier. Most shippers I have worked with have a heartfelt dislike of revenue-based incentives. But, they don't have to cause you pain IF you understand them and manage them properly.

From the carriers' perspectives revenue-based incentives do serve a purpose. Until the late 90s incentives had mostly been either weight-based, or zone-based, or simply applied at the service level. However, this left carriers exposed to a large problem. A shipper could give a carrier only a small slice of their parcel portfolio and still receive the discounts that had been targeted at the entire portfolio. Thus revenue-based discounts were born. While the structures of these programs have evolved over time, the goal is still the same. Ship your entire portfolio with a carrier, you get the targeted discounts. Grow your business, you get higher discounts. Shift business away from a carrier you get lower discounts.

Let's take a moment to understand how these programs work. It is important to remember that agreements can be structured in any way imaginable (and some that aren't), so read your agreement carefully. However, in general the carriers' revenue-based programs are structured as follows:

FedEx Earned Discounts:

Calculation Includes: Gross transportation charges only. No accessorials or surcharges. Typically includes only Ground and Express service levels, but can include other modalities as well (Smartpost, FedEx Freight, etc.)

Calculation Period: Typically a rolling 52-week average

Calculation Basis: Annualized Gross Charges

Special Features: Earned Discounts typically begin with a grace discount. This discount provides a specific discount for period of time to allow the shipper to make any necessary transitions to FedEx. The calculation begins with the last week of the grace period. Each week the gross charges are annualized and applied

to the Earned Discount table to determine the applicable discount. Once the calculation has been effective for 52-weeks, this becomes a simple rolling 52-week calculation.

UPS:

Calculation Includes: Gross transportation charges, residential surcharges, and Delivery Area/Extended Area surcharges. Can include modalities other than small parcel

Calculation Period: Typically a rolling 52-week average, but UPS uses other calculation periods (13-week rolling average, etc.) more frequently than does FedEx

Calculation Basis: Average weekly

Special Features: The first week's discounts are based solely on the first week's gross charges

It is impossible to fully describe the intricacies of revenue-based incentives in a short article. But there are a number of key takeaways:

Revenue tiers should be set such that they are achievable and, more importantly, maintainable

Just because your revenue attainment is \$XXX today does not mean you will be able to maintain that level going forward. In general we recommend setting the targeted tier at no greater than 85% of your current attainment (assuming no volume declines are anticipated)

Account for future plans

Many shippers fail to anticipate the impact of optimization efforts on their revenue tiers. For example if you intend to shift air packages to ground to reduce transportation costs your revenue attainment will be significantly impacted, even if volumes remain constant. Remember that any change in your current shipping patterns can affect your revenue attainment.

Consider seasonality

If a new revenue calculation begins during your slow season you will not likely achieve the targeted tier immediately. More importantly, even

when package volumes increase during your busy season it will take time for those heavy weeks to compensate for the light weeks that have come before. Thus you will not achieve the targeted discounts until you are well into your busy season.

The calculation period matters

If you allow a calculation period other than a 52-week rolling average your discounts could roller coaster throughout the year. During your light season(s) peak revenues may not even be considered in the calculation, resulting in lower discounts during your light season. We recommend 52-week rolling averages in most cases.

Monitor, monitor, monitor

Even if you've done everything right, things can still go wrong. Expect the unexpected. Monitor your revenue attainment weekly and track your revenue attainment over time. If you see yourself trending downward toward a lower revenue tier be proactive. Do not wait until you are two weeks away from falling out of your targeted tier, or worse still until you have already fallen out, to engage your carrier and adjust the revenue tiers.

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