# WHITE PAPER

## With the 2012 Rate Increase, Now's a Great Time to Renegotiate Your Parcel Contract

By Rob Nelson, Thomas Andersen and Victor Zhou

### INTRODUCTION

Another year, another major carrier rate increase. Thanks to the vigilance with which FedEx and UPS have been raising their shipping rates in recent years, most parcel shippers will find their shipping costs increasing by a smaller percentage than in years past. That being said, it is still essential that businesses understand the distribution and impacts of the General Rate Increase (GRI) across each service level, weight, and zone distribution relevant to their shipping needs.

Most of the increases customers will see in their invoice totals are going to come from the transportation costs associated with each individual shipment. The stated GRI for both major carriers remain the same for 2012 as 2011:

UPS:

- 6.9% Air & Int'l less 2% for fuel – net 4.9% increase
- 5.9% Ground less 1% for fuel – net 4.9% increase

FedEx:

- 5.9% Domestic, Express & US Export less 2% for fuel – net 3.9% increase
- 5.9% Ground & Home Delivery less 1% for fuel – net 4.9% increase

These are aggregate averages across a broad spectrum of rates. Each of the carriers have targeted specific zones and weight classes based on their own internal metrics so that every individual shipment rate receives an adjustment that falls below, above, and in some cases, significantly above, the stated average increase. That's why having an independent party analyze and benchmark your carrier agreement against other organizations in your industry is not just a nice thing to do—it's vital.

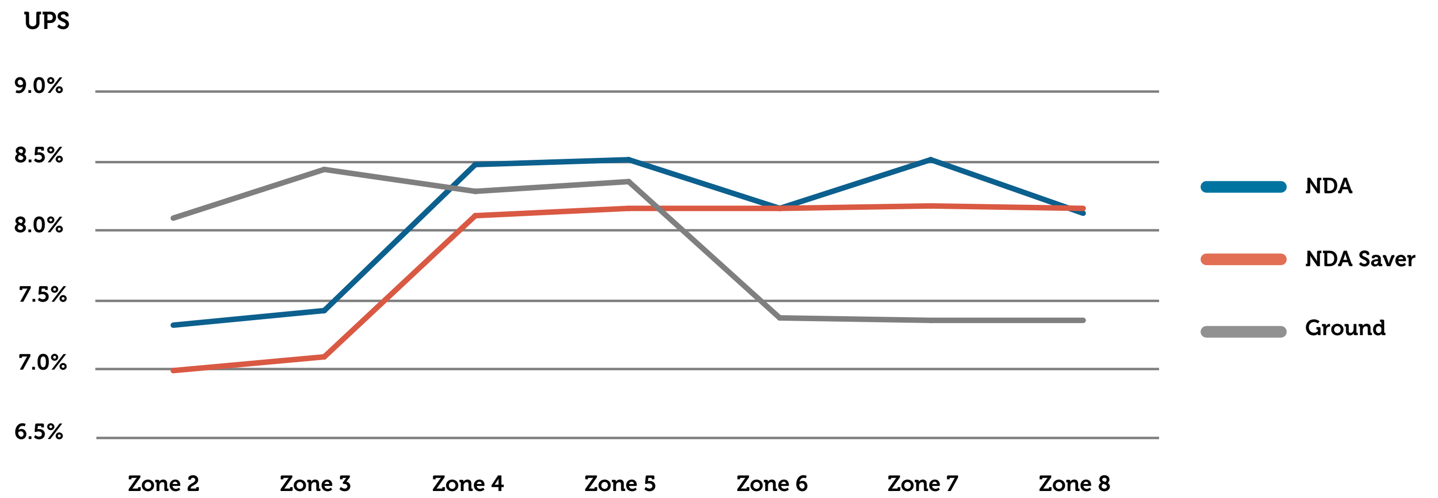
### RATE INCREASES ARE GREATER THAN THEY APPEAR

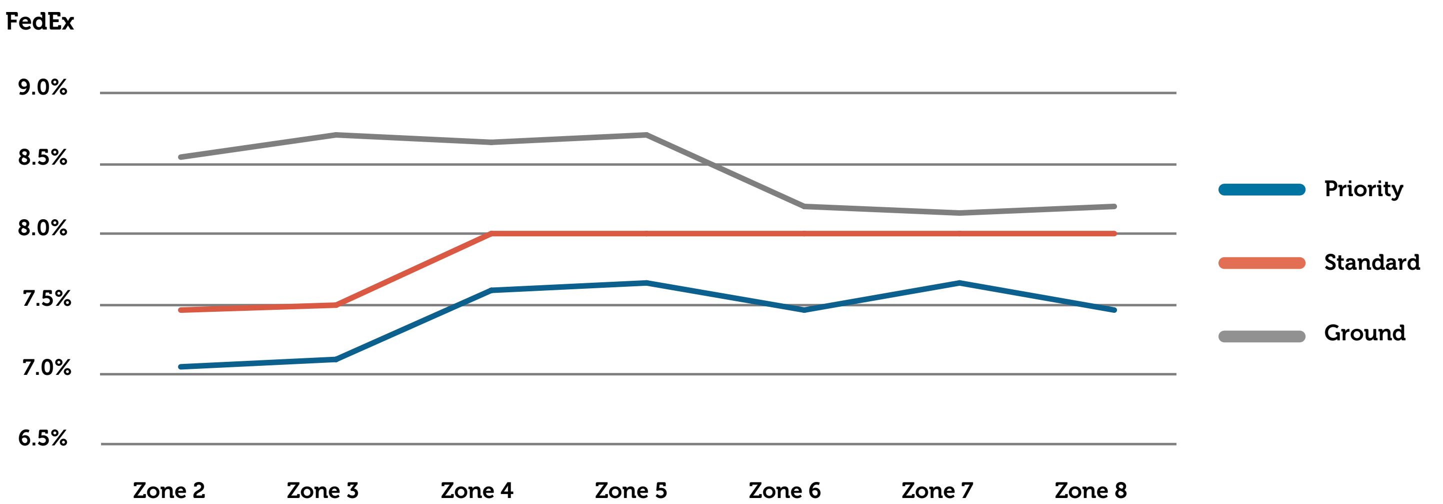
Superficially, the good news for shippers is that from a service level perspective, 2012 Ground Rates (along with Early AM, or Next Day, rates), had the lowest percentage increase they have had in the last 5 years. This basic ground service, the one most commonly used by customers, received a stated increase of 5.9% on both carriers. However, as the chart below points out, on a rate by rate basis these averages are skewed considerably. Why? Simply put, the more numerous but less utilized weights are getting increases below that average, whereas the few weights that the carriers see most commonly shipped have much higher increases.

| UPS Ground Weight Range (lbs.) | Zone 2 | Zone 3 | Zone 4 | Zone 5 | Zone 6 | Zone 7 | Zone 8 |
|---|---|---|---|---|---|---|---|
| 1-5 | 8.11% | 8.44% | 8.30% | 8.37% | 7.37% | 7.33% | 7.34% |
| 6-10 | 7.51% | 7.89% | 8.18% | 8.14% | 6.86% | 7.09% | 7.02% |
| 11-25 | 6.93% | 7.09% | 6.99% | 7.54% | 6.23% | 6.70% | 6.47% |
| 26-50 | 5.54% | 5.62% | 5.48% | 6.27% | 6.02% | 6.13% | 5.51% |
| 51-150 | 3.27% | 2.48% | 2.09% | 2.76% | 2.78% | 2.80% | 2.62% |

The FedEx Ground and Home Delivery rates increased by very similar percentages in 2012—in fact, the rate increases for FedEx and UPS were identical for shipments 70 lbs and under. Note that the numbers above are averages within the specified weight ranges. For shipments 1-5 lbs. to zone two the carriers have said that the average increase is on that shipment is 8.11%. But, in reality, an actual 3 lb shipment to zone two went from $5.45 to $5.93, an increase of 8.8%. The undiscounted minimum rate itself, the 1 lb Zone 2 rate for most contracts, increased 6.1% from $5.17 to $5.49. It is important to keep this number in mind as you negotiate pricing contracts with the carriers. Without any deductions to your minimum, many of your lower weight shipment rates would bottom out at this fixed floor even after taking into consideration any discounts the carriers are giving you for that service level.

Another factor to consider is how the rate increase is being applied across each zone. The two charts below illustrate the average 2012 increase across zones for packages five pounds or less for Ground and Next Day service:



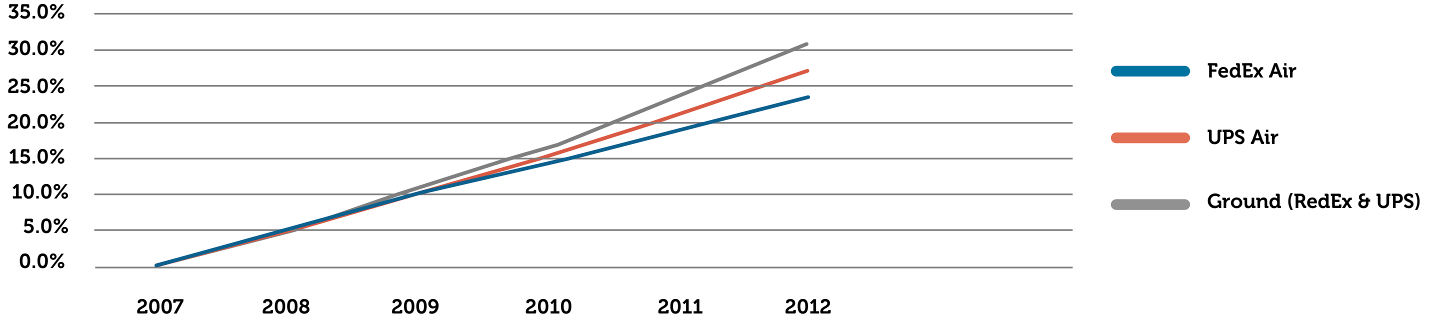
The graphs above outline how UPS and FedEx are strategically targeting higher increases for the zones seeing higher shipping volume specific to their service level. As a shipper, it would not make sense to use Next Day Air service for lower zone shipments when they can get similar results with much lower Ground (or 2-3 day) tariffs. The carriers accordingly raise the low zone Ground rates by a higher percentage while keeping the increases low for Next Day shipments within the same zones so that the average increase of the latter is maintained at or near their target stated rate. The opposite applies for the higher zones, which see a lot more Next Day traffic so keep in mind that a higher percentage increase for these already high rates will amplify the actual dollar increase you will see on your final invoices.

The UPS Daily Rates (used in the tables and charts above) have traditionally been lower than FedEx's List Rates, but this has been offset in past years by higher discounts offered by FedEx to their contracted clients. In 2011 UPS introduced a Standard List Rate tariff that mimics most of FedEx's List Rates. As of now most UPS clients are still receiving the Daily Rates, but some customers who have negotiated new contracts since their inception in 2011 will have already switched over to the newer, and higher, List Rates. Because they are structured to streamline with FedEx's rates, the 2012 UPS List Rate increases mostly mirror their FedEx counterparts. As for their Daily Rates, you can see in many instances from the above charts that UPS has been increasing them more aggressively to bring them in line with their own Standard List Rates, as well as FedEx's.

While we have analyzed patterns thus far according to weight, zone, and service levels, it is important to remember that, across a very broad spectrum of rates, there are always outliers and exceptions. For example, while the overall trend sees higher increases concentrated for lighter weight ranges, don't discount the possibility of significant, and surprising, increases for heavier shipments. For example, take FedEx's Standard Overnight Service. From the table below, you can see that while zones 2-4 saw rates increase significantly in the middle weight ranges before dropping to smaller percentages in the heavier weights, zones 5-8 sees similarly high increases on both ends of the weight spectrum.

| FedEx Overnight Weight Range (lbs.) | Zone 2 | Zone 3 | Zone 4 | Zone 5 | Zone 6 | Zone 7 | Zone 8 |
|---|---|---|---|---|---|---|---|
| 1-5 | 5.80% | 5.91% | 6.93% | 6.96% | 6.97% | 6.96% | 6.97% |
| 6-10 | 5.73% | 5.95% | 6.98% | 6.97% | 6.96% | 6.96% | 6.97% |
| 11-25 | 5.94% | 5.95% | 6.95% | 6.94% | 6.93% | 6.98% | 6.98% |
| 26-75 | 5.97% | 5.98% | 6.81% | 6.93% | 6.81% | 6.92% | 6.96% |
| 75-100 | 5.86% | 5.96% | 5.94% | 6.62% | 5.46% | 6.37% | 5.95% |
| 101-150 | 5.59% | 5.61% | 6.79% | 6.86% | 6.94% | 6.94% | 6.90% |

The main takeaway is that, while higher increases in the past have allowed the carriers to introduce more modest increases in 2012 relative to prior years, there is no doubt that rates and fees have increased, and will continue to increase at levels beyond the averages the carriers publish regardless of economic conditions. As seen below, the compounded effect of each year's increase means that the same shipment in 2012 is costing shippers in many cases more than 30% compared to 2007 **based on stated averages alone**. Even worse, the actual rate increase many customers have seen through this period will have been materially higher.



## INTERNATIONAL INCREASES

Ground shipments to Canada increased along similar lines as domestic ground shipments. As you can see below, most of the higher increases are concentrated within the lower weights and the lower zones. FedEx's two Ground to Canada zones (Z51 & Z54) have the same rates and increases as UPS does for all weights under 50 lbs. (with only slight differences for heavier shipments).

| UPS Ground Canada (Export) Weight Range (lbs) | Z051 | Z052 | Z053 | Z054 | Z055 | Z056 |
|---|---|---|---|---|---|---|
| 1-5 | 7.60% | 7.75% | 7.60% | 7.55% | 7.34% | 7.41% |
| 6-10 | 7.18% | 7.12% | 6.78% | 6.64% | 6.43% | 6.39% |
| 11-25 | 6.27% | 5.98% | 5.74% | 5.72% | 5.50% | 5.49% |
| 26-50 | 5.69% | 5.16% | 5.15% | 5.15% | 4.92% | 4.91% |
| 51-150 | 4.70% | 4.15% | 3.70% | 4.05% | 3.92% | 3.91% |

As for more far-flung international shipments, FedEx has reorganized several zones around different countries in 2012, zones E, K, & M in particular. Most Central American countries such as Panama and Costa Rica were moved from Zone K to Zone L (to join other South American countries such as Brazil and Argentina), while some Pacific Island countries shifted from Zone K to Zone M. Middle Eastern countries such as Israel, Saudi Arabia, and Turkey moved into Zone K for 2012. Additionally, Zone M, which had before contained a very geographically scattered group of countries, was winnowed down causing many Eastern European countries, such as Russia and Poland, as well as South Africa, to move from Zone M to Zone E. The majority of Western European countries stayed in the same zones in 2012 with the exceptions of Germany and Italy, which moved from Zone E to Zone D.
It is important to take these changes into consideration when calculating year-over-year cost increases. For example, while both Zone D and Zone E had identical rates in 2011 for FedEx International Priority, Germany and Italy saw identical rate changes with other Zone D countries such as France and the United Kingdom (5.5% average across all weight ranges). Internationall Economy, however, had varying rates between Zone D and Zone E in 2011, and you can see the differences between Germany, Italy and other Zone D countries below:

**FedEx Int'l Economy (Export)**

| Country/Zone | 1-5 | 6-10 | 11-25 | 26-50 | 51-99 |
|---|---|---|---|---|---|
| Zone D | 6.5% | 6.5% | 6.5% | 7.4% | 11.7% |
| Germany/Italy | 6.5% | 5.4% | 4.2% | 6.0% | 7.5% |

Similar analysis should be done on other countries with zone shifts before costs can be properly projected.

## SURCHARGES AND FEES

In addition to the compounded rate increases mentioned above, there is more to take into consideration, even for a simple ground shipment. For example, accessorial fees and surcharges, which are mostly uniform between UPS and FedEx, have increased as well. The two most common ones in particular, the Delivery Area Surcharge and the Residential Delivery Fee, have seen increases across the board. For FedEx, these increases range from 8.1% for Commercial DAS's to 9.1% for both Residential Surcharges and Residential DAS's—well beyond the stated transportation increases. The actual dollar amount, $0.25 in the case of an Extended Residential DAS (from $3.00 to $3.25), may not be much, but because they are so often applicable to your shipments, these 2012 fee increases will have a material impact on your total spend. It is also necessary to be aware of the possibility of carriers expanding their criteria on the "extended area" zip codes, something they have done consistently in the past. The same shipment to a newly extended zip code in 2012 will see two tiers of increases compared to 2011: one reflecting the annual GRI increase, and again to account for the extended area premium.

The below table summarizes many of the UPS surcharges and fees from 2008-2012:

| UPS fees | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Additional Handling | $ 6.50 | $ 8.00 | $ 8.00 | $ 8.00 | $ 8.50 |
| Address Correction – Air | $ 10.00 | $ 10.00 | $ 11.00 | $ 11.00 | $ 11.00 |
| Address Correction – Grnd | $ 6.00 | $ 8.00 | $ 10.00 | $ 11.00 | $ 11.00 |
| C.O.D | $ 9.00 | $ 9.00 | $ 10.00 | $ 10.50 | $ 11.00 |
| ChargeBack | $ 10.00 | $ 10.00 | $ 10.00 | $ 11.00 | $ 11.00 |
| Declared Value | $ 0.60 | $ 0.60 | $ 0.70 | $ 0.75 | $ 0.80 |
| Declared Value Min Charge | $ 1.80 | $ 1.95 | $ 2.10 | $ 2.25 | $ 2.40 |
| Delivery Area Surcharge – Comm | $ 1.50 | $ 1.60 | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge - Res Air | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 2.75 |
| Delivery Area Surcharge - Res Ground | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Delivery Area Surcharge Ext – Comm | $ 1.50 | $ 1.60 | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge Ext – Res | $ 2.30 | $ 2.65 | $ 2.75 | $ 3.00 | $ 3.25 |
| Delivery Confirmation | $ 1.50 | $ 1.75 | $ 2.00 | $ 2.00 | $ 2.00 |
| Delivery Confirmation - Sig Reqrd | $ 2.50 | $ 2.75 | $ 3.00 | $ 3.25 | $ 3.50 |
| Delivery Confirmation - Adult Sig | $ 3.50 | $ 3.75 | $ 4.00 | $ 4.25 | $ 4.50 |
| Large Package Fee | $ 45.00 | $ 45.00 | $ 50.00 | $ 50.00 | $ 55.00 |
| Missing / Invalid Account # | $ 10.00 | $ 10.00 | $ 10.00 | $ 11.00 | $ 11.00 |
| Residential Surcharge – Air | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Residential Surcharge Ground | $ 1.95 | $ 2.05 | $ 2.20 | $ 2.45 | $ 2.55 |
| Saturday Delivery | $ 12.50 | $ 15.00 | $ 15.00 | $ 15.00 | $ 15.00 |
| Saturday Pickup | $ 12.50 | $ 15.00 | $ 15.00 | $ 15.00 | $ 15.00 |
| Service Charge | $ 8.00 | $ 9.00 | $ 10.00 | $ 10.00 | $ 10.00 |
| Dim Divisor - Domestic Air | 194 | 194 | 194 | 166 | 166 |
| Dim Divisor - Domestic Ground | 194 | 194 | 194 | 166 | 166 |
| Dim Divisor - Int'l Air | 166 | 166 | 166 | 139 | 139 |
| Dim Divisor - Int'l Ground | 166 | 166 | 166 | 139 | 139 |

Note the dimensional divisors at the bottom. These are a way for carriers to amplify the billed weight of boxed packages whose dimensions exceed the limits set by UPS and FedEx. The 2011 decrease in the divisor resulted in unanticipated higher shipping costs for many of our customers. Fortunately these divisors remain the same in 2012, but like other costs and fees that shippers face, the damage has already been done. (For more information about Dim Divisors, please see Thomas Andersen's article on the subject published in the December 2010 issue of Parcel.)

Finally, the FedEx Accessorial Fees from 2008-2012 are listed below. Though the taxonomic structure varies slightly from UPS, with additional DAS delivery categories including Home Delivery, most of the fees remain the same or similar.

| FedEx fees | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Additional Handling | $ 6.50 | $ 7.50 | $ 7.50 | $ 8.00 | $ 8.50 |
| Address Correction | $ 10.00 | $ 10.00 | $ 11.00 | $ 11.00 | $ 11.00 |
| Address Correction (Ground) | $ 6.00 | $ 8.00 | $ 10.00 | $ 11.00 | $ 11.00 |
| Adult Sig Required (Exp) | $ 3.50 | $ 3.75 | $ 4.00 | $ 4.25 | $ 4.50 |
| Adult Sig Required (Grnd) | $ 3.50 | $ 3.75 | $ 4.00 | $ 4.25 | $ 4.50 |
| C.O.D. Fee | $ 9.00 | $ 9.00 | $ 10.00 | $ 10.00 | $ 11.00 |
| C.O.D. Fee – Ground | $ 9.00 | $ 9.00 | $ 10.00 | $ 10.00 | $ 11.00 |
| Declared Value (value per $100) | $ 0.60 | $ 0.65 | $ 0.70 | $ 0.75 | $ 0.80 |
| Delivery Area Surcharge – Comm (Exp) | $ 1.50 | $ 1.60 | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge – Comm (Grd) | $ 1.50 | $ 1.60 | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge – Ext Com (Exp) | ** | ** | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge – Ext Com (Grd) | ** | ** | $ 1.70 | $ 1.85 | $ 2.00 |
| Delivery Area Surcharge – Ext Res (Exp) | ** | ** | $ 2.75 | $ 3.00 | $ 3.25 |
| Delivery Area Surcharge – Ext Res (Grd) | ** | ** | $ 2.75 | $ 3.00 | $ 3.25 |
| Delivery Area Surcharge – Ext Res (HD) | ** | ** | $ 2.75 | $ 3.00 | $ 3.25 |
| Delivery Area Surcharge – Res (Exp) | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Delivery Area Surcharge – Res (Grnd) | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Delivery Area Surcharge – Res HD (Grd) | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 2.75 |
| Delivery Confirmation | $ - | $ - | $ - | $ - | $ - |
| Direct Sig Required (Exp) | $ 2.50 | $ 2.75 | $ 3.00 | $ 3.25 | $ 3.50 |
| Direct Sig Required (Grnd) | $ 2.50 | $ 2.75 | $ 3.00 | $ 3.25 | $ 3.50 |
| Dry Ice | $ - | $ 5.00 | $ 5.00 | $ 5.00 | $ 5.00 |
| Home Delivery Res Del | $ 1.95 | $ 2.05 | $ 2.20 | $ 2.45 | $ 2.55 |
| Indirect Sig Required (Exp) | $ 1.50 | $ 1.75 | $ 1.75 | $ 2.00 | $ 2.00 |
| Indirect Sig Required (Grnd) | $ 1.50 | $ 1.75 | $ 1.75 | $ 2.00 | $ 2.00 |
| Multiweight Address Correction | $ 6.00 | $ 8.00 | $ 10.00 | $ 11.00 | $ 11.00 |
| Oversize Package | $ 45.00 | $ 45.00 | $ 50.00 | $ 50.00 | $ 55.00 |
| Residential Delivery - Rural (Grnd) | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Residential Delivery (Grnd) | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Residential Delivery Surcharge | $ 2.30 | $ 2.40 | $ 2.50 | $ 2.75 | $ 3.00 |
| Saturday Delivery Charge | $ 12.50 | $ 15.00 | $ 15.00 | $ 15.00 | $ 15.00 |
| Saturday Pickup Charge | $ 12.50 | $ 15.00 | $ 15.00 | $ 15.00 | $ 15.00 |
| Dim Divisor - Domestic Air | 194 | 194 | 194 | 166 | 166 |
| Dim Divisor - Domestic Ground | 194 | 194 | 194 | 166 | 166 |
| Dim Divisor - International Air | 166 | 166 | 166 | 139 | 139 |
| Dim Divisor - International Ground | 166 | 166 | 166 | 139 | 139 |

As you can see on a year-over-year basis, the carriers do not always increase all of their fees all of the time, but nevertheless most of their fees have seen increases since 2008. While some fees and services, such as Address Corrections and Saturday Pickups and Deliveries, remain the same in 2012, others, such as Large Package Fees, C.O.D.'s and different Delivery Confirmation Surcharges, saw increases of up to 10% this year. Having a solid grasp of your shipment analytics will allow you to identify which fees, as well as other unexpected charges like Late Payment, Pickup, or Invalid Acct Fees, are most commonly incurred, and this knowledge will provide you with a better framework when approaching the carriers for either your initial rate negotiations or even renegotiations.

## FUEL SURCHARGES: A VARIABLE EXPENSE

Though they are not listed above, fuel surcharges are a key component of your accessorial charges. They can account for ten percent of the transportation cost, or more, depending on the percentage in the fuel index in effect at the time of the shipment, as well as the fees that are being impacted by the fuel surcharge. Most people we talk to are not aware that the fuel surcharge not only applies as a percentage of your base rate, but also to select fees, like:

- Residential Delivery Charges
- Delivery Charges
- Pickup Charges
- Return Services Charges
- A.M. Charges
- International Extended Area Charges
- Saturday Delivery and Pickup
- Large Package Surcharge

The fuel surcharge is applied in a similar fashion by both carriers, but the slight differences could have a meaningful impact based on your shipment trends.

## IMPROVED SERVICE LEADS TO HEALTHY COMPETITION

Whether you prioritize your logistics needs on any combination of convenience, reliability, on time performance, controlling damages, or any other criteria, we all want to work with a reli¬able carrier that meets our service expectations. Although FedEx and UPS justify their rates and increases by claiming to protect margins and yield, they are still, in the end run, competing for your business. As a result, there remains pricing flexibility from the carriers consistent with what we have seen in the past.

The carriers invest a tremendous amount of capital in facilities, fleet and transportation costs, and personnel at the regional hub, as well as at the local level. These are fixed overhead costs that remain relatively unchanged for the carriers, whether utilization is at 90% or at 60%. For ex¬ample, $90,000 in fixed costs applied to 45,000 shipments results in a $2.00 cost per shipment. At 60% utilization, the same fixed cost of $90,000 would be applied to 30,000 shipments, which increases the allocated cost per shipment for the carriers to $3.00. When applied at a shipment level, the impact is certainly substantial. The need to maintain sufficient utilization levels then becomes critical for the carriers in order to keep sustaining their overall positive margin and return on investments. From a customer-specific perspective, this generates pressure on UPS and FedEx to take unusual, aggressive steps to protect their existing book of business. That means that while their profit mar¬gins may be negatively impacted for one customer, the consistency of their continued shipping levels helps protect the overall financial strategy of each carrier.

## DISCOUNTS AND FEE FLEXIBILITY

The most obvious opportunity for savings often lies within the rates themselves. The minimum charges on ground shipments may be negotiable and flexibility does exist on discounts. Competitive pressure between the carriers and your own shipment profile, are key components to what options may exist for the shipper. A solid grasp of key variables including, but not limited to, dimensions of packaging, conveyability, pickup and delivery density, single versus multi-piece, commodity type, need for special handling, perishability, hazardous materials, weights, services and products, and zone distributions will help you get a better contract specifically tailored to your business and impactful to your bottom line.

For many shippers, the fee with the greatest financial impact is the Fuel Surcharge. While these costs are often dependent on external market and geo-political forces beyond the control of the carriers, there is still room for negotiation. After all, there is a significant difference in the cost of transporting packages via ground vs. via air.

Considering that carriers have been increasing their margins by shifting a higher percentage of "air" shipments to zones 2-4 from actual air to ground and rail transport, there exists opportunities within that expanded revenue, now new profit on their end, that can be passed down to you, the customer, via negotiations.

## SUMMARY

In the end, remember that your spend is extremely important to the carriers! Each one has specific discounts, fees, rebates, and incentives that are negotiable beyond just the initial offer they put on the table. Taking the time to analyze your shipment profile and assess your needs versus your costs will allow you to negotiate discounts and fees beyond just their average, standard template contract, to one that fits your business and operations model. Most importantly, a current contract with any of the carriers does not mean you must continue to overpay, and having another year or two left on your current contract does not limit your ability to negotiate any component of your contract, as a 30 day out clause exists, for you the customer, as well as the carrier. Additionally, the unexpected and unstated increases that accompany the 2012 GRI are a great reason for you to introduce your concerns now about rising shipping costs when you have the conversation with your carrier. Ultimately, the bottom-line is that the flexibility to negotiate your small parcel typically exists, as long as you understand your business, recognize what flexibility exists with each of the carriers, and know how and when to ask for the right kind of discounts.

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