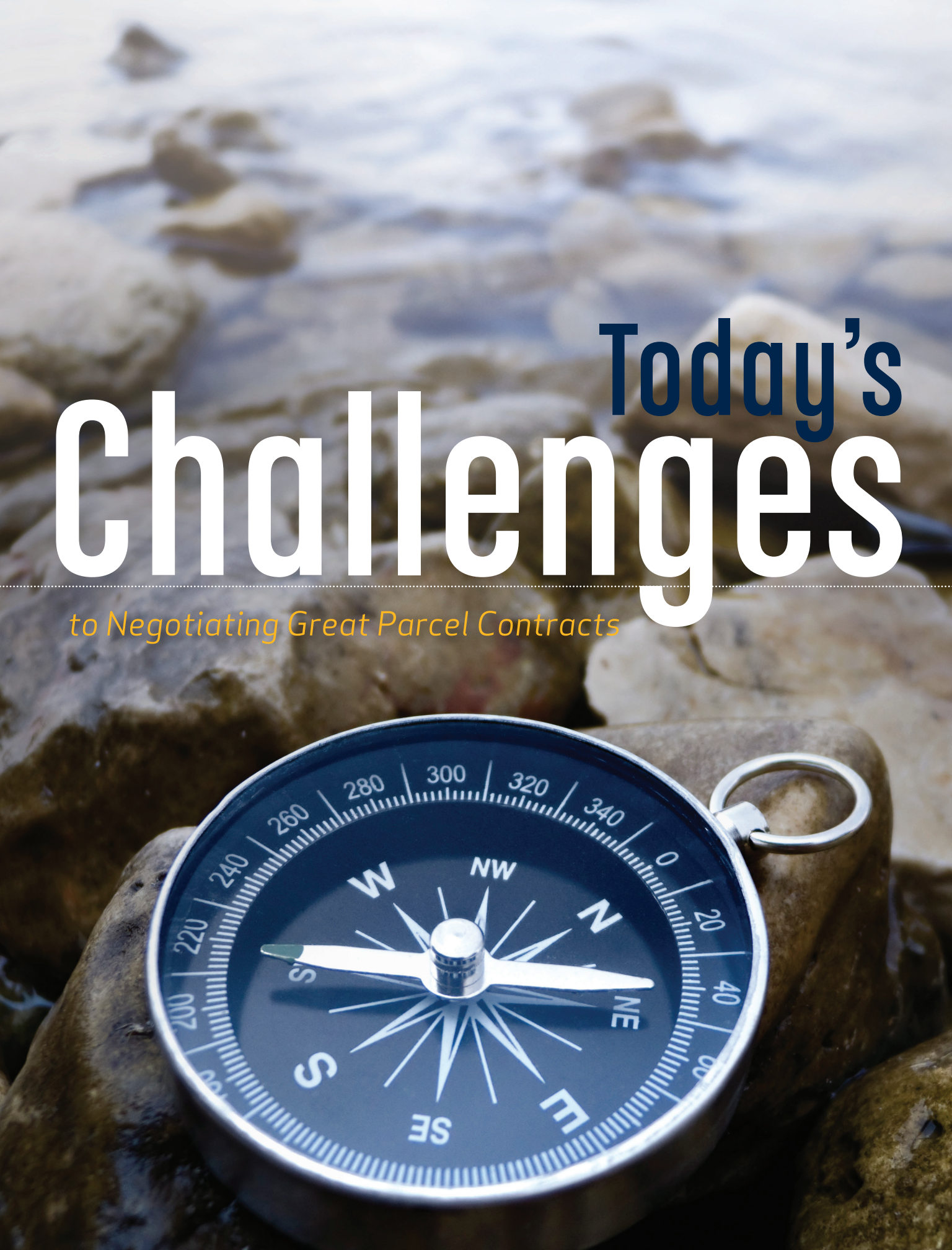
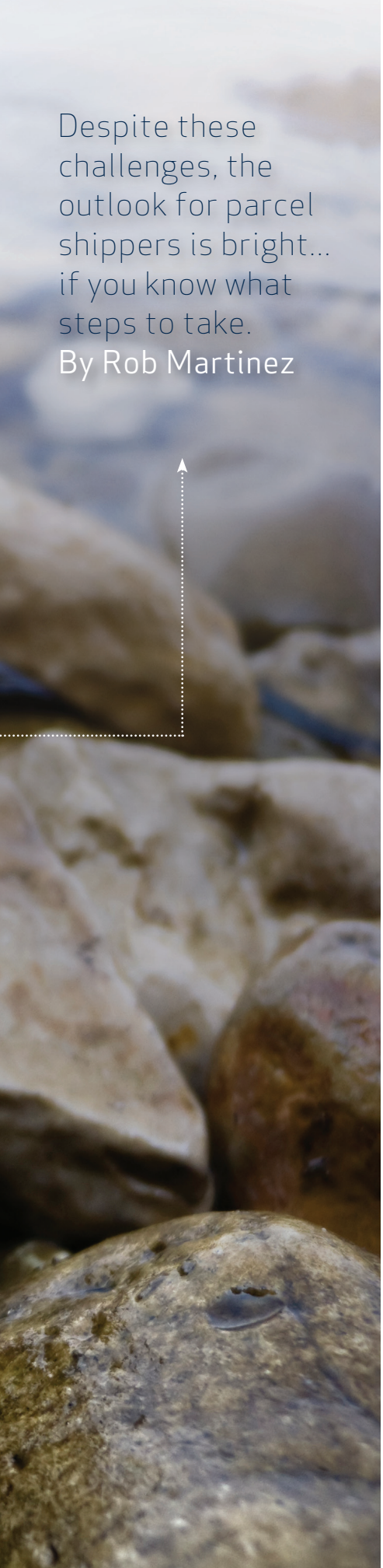
Today's Challenges

to Negotiating Great Parcel Contracts





Despite these challenges, the outlook for parcel shippers is bright... if you know what steps to take.

By Rob Martinez

SO you ship lots of packages and spend tons of money with the parcel carriers. Millions even. You're a big customer. You've been invited to their hubs. And to major sporting events. Once a year, you get a visit from a high ranking title from Atlanta or Memphis. You've even been assigned a dedicated, national account representative who's in your building all the time.

Then why do you feel like such a small fish when it comes time to negotiate your parcel contract?

Make no mistake about it. It's harder now. And you're not alone.

In our 2011 PARCEL Survey on Pricing & Benchmarks, by a margin of 4 to 1, shippers feel it's harder today than ever to negotiate parcel contracts. Asked why, the top four responses were: 1) Lack of competition within parcel provider market; 2) Carriers' focus on yield management; 3) Pricing has become commoditized; and 4) FedEx and UPS have a tacit agreement to avoid pricing wars.

Part One of this article addresses several challenges to negotiating best-in-class parcel agreements in today's margin-focused market. Part Two provides suggested strategies and solutions.

PART ONE – CHALLENGES

FEW NATIONAL PARCEL PROVIDERS

When I started my career in the parcel business, there were multiple carriers competing for parcel volumes. In addition to FedEx and UPS, there was Airborne Express, DHL, Flying Tigers, Burlington, BAX Global, Emery and even Purolator. Now we're down to only two national private parcel carriers in the US — FedEx and UPS.

Of course, it's difficult to create negotiating leverage with little competition in the market, especially when those companies' stated focus is on margin improvement, i.e. making as much money as possible on every shipment.

RISING PARCEL COSTS

As competition in the parcel market has winnowed, annual rate hikes have sharply increased. A study of FedEx and UPS annual rate increases reflects a shift in the market pricing around 2006. Rate increases for the most recent eight years (2006-2013) are roughly double the previous eight years (1998-2005). See Table 1.

GRI HISTORY	UPS AIR	FEDEX AIR	UPS GROUND	FEDEX GROUND
1998	3.30%	3.50%	3.60%	3.70%
1999	2.50%	2.80%	2.50%	2.30%
2000	3.50%	0.00%	3.10%	3.10%
2001	3.70%	4.90%	3.10%	3.10%
2002	4.00%	3.50%	3.50%	3.50%
2003	3.20%	3.50%	3.90%	3.90%
2004	2.90%	2.50%	1.90%	1.90%
2005	2.90%	4.60%	2.90%	2.90%
2006	5.50%	5.50%	3.90%	3.90%
2007	6.90%	6.90%	4.90%	4.90%
2008	6.90%	6.90%	4.90%	4.90%
2009	6.90%	6.90%	5.90%	5.90%
2010	6.90%	5.90%	4.90%	4.90%
2011	6.90%	5.90%	5.90%	5.90%
2012	6.90%	5.90%	5.90%	5.90%
2013	6.50%	5.90%	5.90%	5.90%
Average 1998-2005	**3.25%**	**3.16%**	**3.06%**	**3.05%**
Average 2006-2012	**6.68%**	**6.23%**	**5.28%**	**5.28%**

Table 1

In addition to freight rate hikes, shippers have seen dozens of new accessorial charges over the past decade, many of which did not exist prior to 2006. Accessorial charges — like Delivery Area Surcharges, Fuel Surcharges, Weekly Service Fees, Large Package Surcharges, Additional Handling Service charges and the like — now account for as much as 30% of a shipper's overall costs.

Other service guide changes have caused rates to increase dramatically. Ground minimum charges, for example, have increased an average of 6.3% since 2006. That's a hike of 53.7% over the last eight years. See Table 2.

YEAR	GROUND MINIMUM CHARGE	INCREASE%
2006	3.80%	
2007	4.00%	5.3%
2008	4.20%	5.0%
2009	4.57%	8.8%
2010	4.84%	5.9%
2011	5.17%	6.8%
2012	5.49%	6.2%
2013	5.84%	6.4%
	AVERAGE	**6.3%**
	CUMULATIVE	**53.7%**

Table 2

Shippers have seen several changes over the years on dimensional rating. In 2007, UPS and FedEx adopted the Air dimensional freight policy for Ground shipments over three cubic feet. And of course in 2011, the dimensional divisor changed from 194 to 166 for both Air and Ground. These changes accounted for hundreds of millions in new revenues for the carriers.

COMPLEX AND CONSTRAINING PARCEL AGREEMENTS

Today's parcel agreements are more complex and conditional than ever. In general, rate charts are multi-dimensional, based on service level, weight and zone. Packaging and billing options can also come into play to determine discounts (or loss of discounts). Freight incentives are based on a set of published pricing, which of course changes annually. The structure of incentives is tiered and based on service levels and rolling revenue bands. Revenue bands are based on gross transportation charges — prior to discounts — and exclude accessorial charges. Minimum charges mitigate discounts, as do dimensional charges. And there are dozens of important terms and conditions that can affect your parcel rates.

Additionally, volume shippers are seeing many constraining elements in today's parcel agreements. Several clauses are often inserted to minimize defection to alternative carriers. These include diversion and minimum net charges penalties as well as early termination agreements. In each of these three cases, a shipper would literally have to pay the carrier financial penalties to divert business to another provider, failing to achieve minimum revenue objectives, or terminating the carrier agreement prior to term expiration.

UNEVEN PLAYING FIELD

One of the biggest mistakes I see repeatedly is a shipper coming to the negotiation table unprepared. Very often, carriers know more about a shipper's distribution than the shipper. Not too surprising since the carriers "own" your shipping data. Moreover, shippers often don't understand the impact of terms and structure of their carrier agreements.

Perhaps most importantly, shippers lack benchmarks. Benchmarks provide data points from other companies for comparative purposes. For example, imagine going into a negotiation knowing that you were being charged 20% more than three out of four shippers with similar spend and package characteristics. How much better prepared would you be when your carrier rep says, "You're getting the best deal in our district"?

Finally, many shippers lack analytical tools to better understand distribution metrics, package characteristics, or the impact of pricing actions (new proposal, general rate increase, etc.).

So how do you negotiate best-in-class parcel contracts with FedEx, UPS and other parcel carriers?

PART TWO – SOLUTIONS & STRATEGIES

DO YOUR HOMEWORK PRIOR TO NEGOTIATIONS

Before stepping up to the negotiating table, shippers need to collect and analyze shipment detail to better understand usage, costs, accessorial charges and other variables. Develop reports to understand service usage, seasonality, weight ranges, zonal distribution, accessorial costs, cost per shipment, residential/commercial mix, shipments impacted by minimum and dimensional charges, and other factors.

This detailed analysis gives shippers a priority list to focus on concessions that have the greatest cost savings impact.

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Quantify which accessorial charges most adversely impact costs and target these charges for waivers or reductions during negotiations. Regardless of what your carrier representatives tell you, all accessorial fees are negotiable.

Conduct benchmarks to determine what range of discounting is possible and how your rates compare with other shippers

of similar size and/or package characteristics. If you lack the ability to benchmark internally, there are a number of companies that can assist you in this important process. Many third party market experts are willing to conduct an obligation-free, complimentary assessment of your current rates and terms to assess potential savings.

EXPLORE ALTERNATIVE CARRIER SOLUTIONS, GAIN LEVERAGE

Despite its financial woes, the US Postal Service remains a viable alternative especially for non-urgent, lightweight, residential and/or cubic shipments.

In its Q1 2013 earnings announcement, Shipping and Package Services was a bright spot for the USPS, gaining four percent over the same period a year ago. And Parcel Return and Parcel Select revenue grew 19.2% YOY.

Regional carriers such as Eastern Connection, Lone Star Overnight, OnTrac, Spee-Dee Delivery, PITT-OHIO Ground, LaserShip, TransTek, Prestige Delivery and many others offer reliable parcel delivery services at rates as much as 30% less than national carriers.

There are parcel consolidators — DHL Globalmail, Newgistics, Blue Package, Parcel Pool and others — that compete with FedEx SmartPost and UPS SurePost for Parcel Select service, with the USPS serving as the final mile delivery provider.

Leverage these alternative delivery providers — USPS, regional carriers and parcel consolidators — whenever possible in negotiations with FedEx and UPS.

However, even if you find yourself in negotiations with UPS and FedEx only, you can still effectively lower shipping costs. UPS and FedEx are fierce rivals. Use the other carrier as leverage.

It's important to note that parcel pricing is largely predicated on "cost to serve" models at FedEx and UPS. Both carriers have become very adept at internal cost metrics, developing complex revenue management tools to forecast the profitability of a shipper's business.

FedEx aims to shed $1.7 billion in costs over the next several years. Perhaps you can help.

Collaborate with your carrier rep. Ask for ideas to lower the cost profile of your business. Areas for exploration include increasing the use of automated tender, pickup consolidation, hub bypass options, package tender and materials improvements to lower claims, minimizing high-cost call centers by through online self-tracking, changes to pick up schedules and delivery routes, packaging optimization to improve truck and aircraft utilization, and dozens of other options.

NEGOTIATE, NEGOTIATE, NEGOTIATE!

Use leverage in your negotiations. Meet with alternative providers including regional carriers, parcel consolidators and the US Postal Service. Conduct annual bids, consider splitting your business amongst multiple providers, and meet regularly with non-incumbent carriers.

Carefully evaluate each carrier proposal. If discounts are tied to rolling averages and revenue thresholds, make sure you have the business to support targeted revenue bands. Make certain your contract includes discounts for all services. Understand the impact of minimum charges and dimensional rating. Try to negotiate waivers or caps to the annual January rate increases.

The best carrier pricing programs are often obtained through competition. If you haven't changed carriers for some time, chances are you're spending too much. Carrier sales representatives are commissioned in part on profit margin. Therefore, most reps are not willing to offer extensive discounts unless forced to compete for your business.

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Don't get locked into constraining terms. Push back on deferral penalties, early termination clauses and other constraining language. Try to maximize base discounts, rather than building incentives into revenue thresholds and rebates. If forced into revenue-based discounts, leave considerable room should you elect to move a portion of your business to another carrier.

Consider the services of third party market experts for distribution analysis, contract benchmarking, and parcel procurement. According to Morgan Stanley's Annual Best Practices Survey, 11% of the top 400 parcel shippers in the US have hired consultants to negotiate their FedEx, UPS, DHL and other transportation contracts. Most notably, these shippers — commanding a collective $1B in annual parcel shipping expenditures — report that parcel consultants reduced shipping costs as much as 49% lower from what the company had been able to negotiate on its own.

Finally, pursue long-term contracts. While you reserve the right to negotiate your contract at any time, fixed term contracts offer shippers rate stability and cost predictability.

While it's clear the present parcel market presents challenges for many shippers, there are many strategies shippers can pursue to reduce costs. Good luck! ■

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