Cut Freight Costs Now

Bring your Transportation Budget Under Control by Going Back to Basics

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INTRODUCTION

If your company is like most others today, you are facing supply chain challenges that are significantly different from those you were battling just one year ago. For the past several years, the industry's attention has been focused on exploding global trade, rising fuel prices, declining trucking capacity and sophisticated technology initiatives (software implementations, RFID, etc.). Supply chain projects were mainly strategic in nature, promising great returns on investment following complex business process redesign and technology implementation. Transportation improvements may have been sidelined in a case of "plenty of cash, too little time."

But the economic slowdown has changed all that. The mandate is to lower costs and improve cash flow – NOW, not 12 months from now. However, most companies are in the situation of "too little cash, too little time." The good news is that the climate is right to reduce your freight spend and introduce policies that will pay off in weeks, not years. The ideas presented in this paper represent a return to transportation fundamentals. They require little or no technology to support (although technology will help), and can in most cases augment existing processes rather than requiring extensive process reengineering. And they can deliver results direct to the bottom line. For a typical company spending anywhere from 3-10% of gross sales on transportation the impact is big, isn't that worth a look?

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SETTING THE STAGE

Before beginning any improvement effort you'll want to make sure that your overall business and logistics strategies are still in alignment – both with each other and also with the current economic environment. In particular you will want to understand how your network and shipping profiles have changed, impacting such fundamental metrics as overall sales, logistics expense as a percent of sales, average shipment size and weight, etc. Old assumptions should no longer be accepted as truth unless they can be validated with data.

With a solid understanding of your logistics strategy, there are several fundamental areas that should be investigated for cost reduction opportunities:

- How your network is optimized
- How freight is purchased
- How freight is planned and executed

NETWORK OPTIMIZATION: INBOUND FREIGHT MANAGEMENT

Most network optimization projects require a significant investment in time, money and materials – the end result typically involves the opening, closing or relocation of facilities as part of a global supply chain initiative. The benefits are often delivered over years. But there is one particular area of network optimization that can yield short-term results and operate within the scope of your current logistics network – inbound freight management.

Inbound freight management was a hot topic in the mid-to-late nineties. Many companies launched efforts to gain visibility and control of their inbound freight. The benefit that motivated those companies is still valid today – one of the most simple and direct methods to cut your freight spend is to take control of inbound freight.

Inbound freight management is fundamentally a basic concept – you change your freight terms from "Delivered" or "Prepay & Add" to "Collect." By changing freight terms you can eliminate vendor handling charges and ensure that freight is hauled by your preferred carriers. In many cases this simple step will lead to reductions in inbound freight expense and can simplify your receiving operations – but not in all cases. Hence, the need for you to do some homework up front:

1. First, analyze your inbound freight to determine who is routing and paying for each lane. You will need to work with your buyers to understand the current purchasing and freight terms.
2. Gather input from receiving personnel to understand any operational concerns. Have them keep a tally of carriers that deliver product to your facilities – you can solicit quotes from them to use as baseline costs.
3. Analyze the freight charges and identify which lanes you believe you can route more effectively and at a lower cost than your vendors. In some cases it may be beneficial to maintain the current "Prepay & Add" freight terms.
4. Prioritize the savings opportunities and have your buyers approach the vendors to renegotiate terms. Give your buyers complete visibility to inbound freight charges, including estimated charges for delivered product. Make sure to highlight and address any operational concerns noted by your receiving personnel.
5. Once the new contracts are in place, publish an inbound routing guide and **make sure to include noncompliance penalties** for vendors who use unapproved carriers.

The benefits derived from an inbound freight management program include: reduced freight expense, increased inbound visibility and control and reduced "maverick" freight spend. The keys to success are a thorough understanding of inbound freight charges and total delivered cost and a process to monitor and enforce compliance with the routing guide.

If you already have an inbound freight management program in place, some extensions to consider include:

- Expand the routing guide compliance program to include expedited freight authorization (SEE EXPEDITED SECTION).
- Collaborate with vendors to select carriers and use each others' private fleets.
- Implement a load control center to take over routing and execution of inbound freight.
- Integrate purchase order management with a TMS (Transportation Management System) for complete inbound visibility.

PROCUREMENT

The most straightforward method to reduce your freight spend is to negotiate lower rates with your carriers. For the first time in many years the advantage has shifted to the shipper. If you have not re-bid your freight in the past 6-12 months, now is the time to do it – freight rates are not going to go much lower. In fact, there are many indications that carriers may have cut rates too drastically in their bid to maintain business and we may see rates begin to climb back up in late 2009/2010.

Freight rates have been driven down by the drastic shift in the supply-demand equation. With the economic slowdown, shipment volumes have plummeted. And although significant capacity has been removed from the market by carrier bankruptcies and the idling of vessels and trucks, shipment volumes have declined even more rapidly. Nowhere has the impact on rates been more extreme than in ocean freight, but rates for all modes are down (with the possible exception of parcel). A formal freight bid will help you take advantage of this buyer's market and lock in more favorable freight rates.

Before moving forward with your freight bid you need to determine your objectives. Are you focused on immediate rate reductions? Do you have concerns about service levels or available capacity? Would you like to standardize your fuel and accessorial charges? What level of partnership are you seeking with your carriers? Your specific objectives will drive your approach to the bid process.

Some things to consider:

1. Developing an accurate benchmark is critical in order to execute an effective bid. You must understand not only your existing rates and tariffs, but also your underlying shipping patterns, volumes and operational requirements. Take into account the reality of current volumes – 2008 may not be a good benchmark year for costs and shipment volumes, particularly when fuel costs are taken into account.
2. To the extent possible include all of your freight in the bid rather than executing separate bids by region or business unit. The larger the bid the more interest you will generate on behalf of the carriers, particularly as they are overwhelmed with bids and pricing requests from other shippers. You also give them a better opportunity to design a solution that best matches their networks.

3. Invite and utilize as many carriers as can be effectively managed as part of the bid process. The purpose of a competitive bid is to allow each carrier to optimize their own network and economics. No one carrier offers the best rate in all lanes and the optimal solution generally requires the use of multiple carriers. You will need to make your own decisions to balance the lowest total cost against the desire to reduce administrative burden and establish core carrier relationships. The more automated your transportation management systems and processes, the more carriers you can effectively manage.
4. If you haven't included some measures of capacity commitment and financial stability in your past bids, now is the time to do it. With carrier bankruptcies on the rise you will want to make sure that your core carriers are going to be around later this year. Selecting the carrier with the lowest rate on a lane means very little if they are unable to provide trucks when needed. Maintaining a portfolio of primary and backup carriers is critical – you may need to allocate freight accordingly to keep these relationships alive.
5. Share as much historical shipping detail as you have available, particularly any unique requirements for cargo liability, handling, scheduling, etc. Carriers build a risk premium into their rates when such information is unavailable. The objective is to provide as clear a picture as possible of the business, rather than hide any operational challenges. Your bias should be to provide more detail rather than less.
6. All analysis must be based on total delivered cost, including freight, fuel, accessorials and other surcharges. Accessorial charges alone can add 10-15% to the base freight rates, and last year saw fuel surcharges surge to 35-40% in some cases. Failing to include them in your analysis is a sure path to failure.
7. If you have sufficient shipping volume you may also want to take this opportunity to standardize fuel surcharge programs and accessorial charges rather than relying on the carriers' individual programs. Disparate programs and surcharges are difficult to manage and audit, and are typically biased in the carrier's favor.
8. Do not forget the volatility of the market and the lessons learned in 2008 – capacity will be an issue again and fuel prices will rise. If you manage your carriers harshly this year, expect them to return the favor in the future. Maintain a long-term view of the market and your carrier relationships and be prepared for the market to shift yet again.

WHERE TO LOOK FOR SAVINGS

- **Ocean Freight** – Overcapacity and declining trade volumes have severely impacted ocean carriers. With steamship lines reporting significant operating losses and little pricing discipline in sight, shippers seemingly hold all the cards. While some carriers are announcing price increases off of the deeply discounted rates seen at the end of 2008, overall rates are still much lower compared to past years, in some cases by 30-40%. There is the opportunity to lower or even eliminate fuel surcharges and peak season surcharges and renegotiate demurrage limits and fees. Watch out for changes to service levels as ships are pulled out of rotation and some services are merged or cut entirely. Transit times may also be impacted as ocean carriers reduce sailing speeds to lower fuel consumption and operating costs. An approach to consider is to reduce the amount of freight under contract and move instead to the spot market in an attempt to take advantage of declining rates throughout the year.
- **Truckload** – As with ocean carriers, the truckload industry has been idling assets and reducing services and still has been unable to adjust to rapidly declining freight volumes. Fierce price competition among carriers has been seen, but rates may have bottomed out as weaker carriers have exited the market. Expect truckload carriers to maintain stronger price and capacity discipline going forward and be prepared for capacity to tighten as the economy begins its recovery. Nevertheless, solid pricing opportunities exist for shippers who have not re-bid their freight in the past 6-9 months. Flatbed capacity in particular is abundant due to the falloff in construction and commodity shipping.
- **Intermodal** – Aggressive pricing and improved transit times have led to significant gains for intermodal over truckload. Look for these gains to continue as the railroads deliver further service improvements. For those shippers who have not evaluated intermodal for a number of years it is worth a second look. The length of haul tradeoff with truckload has been reduced in many lanes from 800-1,000 miles to as little as 500-600 miles. The critical factor in making intermodal competitive over short hauls is the dray distance from the origin and destination to the intermodal rail ramp. Look for drays less than 100 miles for the most competitive rates and transits.
- **Less than Truckload (LTL)** – Due to their large fixed asset base, LTL carrier have been more severely hit by the economic slowdown than truckload carriers. LTL carriers have been very aggressive in pricing to secure freight, particularly the national and super-regional

carriers. Shippers should reevaluate service levels as several carriers have announced reduced transit times as they seek to differentiate their service.

- **Air Freight** – Air freight volumes, both domestically and internationally, have sustained double-digit declines. In particular the major import lanes of Asia-EU and Asia-US have seen cargo demand fall off drastically leading to rate reductions of 20-30%. Shippers can take advantage of these rates, but watch the market closely as carriers reduce lift capacity.

What's Next

Carriers in all modes are working aggressively to cut capacity. As the economy recovers you can expect carriers to be very conservative about adding capacity and take advantage of the resulting supply-demand imbalance to extract pricing premiums. The old issues – driver shortages, fuel costs, environmental regulations, congestion – will return. Relationships matter – and shippers who lay the groundwork now for strong carrier relationships may benefit from a less aggressive approach to rate negotiations.

AUTOMATE/OUTSOURCE FREIGHT BILL AUDIT AND PAYMENT

Most industry sources indicate that is costs anywhere from $10-15 to process a freight bill internally. A freight bill audit and payment (FBAP) provider can process that same bill for $1-2 for a paper invoice and pennies for an electronic parcel invoice. Most shippers claim that FBAP outsourcing saves them 3-5% on their freight spend. And in the process the shipper gains access to rich shipment details that are not captured in typical accounts payable systems.

The shipper benefits in multiple ways:

- Administrative costs are lowered.
- Duplicate invoices, overcharges and invalid surcharges are identified and rejected.
- Analysis can identify shipment and carrier optimization opportunities.
- Compliance with routing guides can be monitored.
- Cost accounting and allocation is streamlined and automated.

If you still audit and pay freight invoices internally, now is the time to consider outsourcing this function.

SHIPMENT PLANNING AND EXECUTION

The objective in planning and executing shipments is to choose the lowest cost mode and carrier that meets required service levels. Lower costs are driven by asset utilization – building larger shipments, loading more product in a trailer, shifting to a more cost effective mode and selecting the lowest cost carrier. If you are one of those shippers who has implemented a Transportation Management System (TMS) this process is a breeze – even the most basic TMS offers some level of shipment optimization. But even if you do not a TMS you can still take certain steps to set up your transportation network and planning processes to drive lower freight costs.

- Information sharing with your carriers is critical. If you can plan your shipments earlier and let the carriers know what to expect 48-72 hours in advance you will avoid paying spot market rates, ensure access to capacity and allow carriers to better schedule their drivers. You increase the likelihood that you will be able to use your lowest cost carrier. You may also put yourself in position to use lower cost modes of transportation.
- Revisit the use of intermodal for truckload lanes with lengths of haul greater than 500 miles. In many cases you will find transit times comparable to solo truckload at rates that are 10-20% cheaper. As noted earlier, the key to effective use of intermodal is minimizing the origin and destination drays.
- Monitor and emphasize compliance with your routing guide, especially if you have multiple sites independently planning and executing their own transportation.
- If you do not have a TMS to perform dynamic shipment consolidation, you can still set up a system that encourages manual shipment consolidation.

- Parcel and air freight shipments to the same destination should be staged together and tendered on the same waybill.
- LTL shipments should be planned and staged by region – multi-stop deliveries can often be less expensive than individual LTL shipments.
- Very large LTL shipments should also be quoted with truckload carriers – a half-full truck can move faster and cost less than an LTL shipment.
- For regions with consistently high volumes of LTL shipments, consider setting up pool points. LTL carriers or 3PL's can provide local pickup and delivery services while the linehaul is handled by a truckload carrier. These programs require more sophisticated setup and coordination (scheduling, labeling of individual shipments, etc.), particularly for inbound freight, but the cost advantage may make the effort worthwhile. Similar "zone skipping" programs can be set up for parcel freight.
- Increase the likelihood of consolidating shipments by increasing shipment density. If possible, set up "sailing schedules" where shipments to certain regions are scheduled for a specific day (or days) of the week.

• Do what you can to make freight driver friendly. Expanding your hours and increasing shipping/receiving flexibility will make your freight more attractive to carriers and can result in lower rates. Allowing carriers to drop trailers will have a similar effect.

The ideas presented in this paper have the dual advantage that they not only can cut transportation costs in the short term, they also make your freight more attractive to carriers and will help you gain access to capacity when the market turns.

EXPEDITED

Expedited freight is more than a mode of transportation – it is a complex business process. It is actually made up of multiple modes – parcel, air freight, truckload, and others. The common factor being that in each case a decision is made to upgrade to a faster (and presumably more expensive) mode of transportation. Where does the challenge (and opportunity) lie? In many organizations expedited freight is simply not effectively managed. Because there is usually a pressing business need to get the freight to its destination more quickly, disciplined analysis and decision-making get thrown out the window. Getting it done – at any price – is the focus. The opportunity for improvement is even greater when one considers your vendors frequently make decisions on whether or not to expedite freight, even when you are the one paying the bill!

The answer is to put in place an expedited management program with the following elements:

• Have a plan in place so you don't have to scramble. If you have to reach out to the spot market every time you need to expedite freight you will end spending a great deal more than you should. For every lane that may require expedited freight, you need to understand your various mode and carrier options and the transit time and cost associated with each. Having this information in place will enable you to step back and make a rational, rather than rushed, decision. And this information needs to be pushed to the persons making the expedite decisions, whether in routing guides used by vendors or work instructions used by your customer service staff.

• Make sure you can measure the use of expedited freight. There is truth in the old adage "you can't manage what you can't measure." Expedited freight is often lost in the general freight budget. It needs to be measured and reported accurately – whether on the back end using freight payment data or up front using other methods.

• Manage the process. With appropriate controls and record-keeping in place you must regularly revisit the data and seek ways to improve the process. On a monthly and quarterly basis the expedited shipment data should be reviewed with all impacted parties (including purchasing, manufacturing and sales) to identify recurring problems and root causes. At some expense threshold a mandatory and immediate "after action review" should evaluate the shipment in detail to identify root causes and eliminate or reduce the impact of future occurrences.

• Require authorization for use of expedited freight. Best practice companies establish strict controls over expedited freight and maintain detailed records of what was expedited, by what means, for what reason and who authorized the shipment. Establish thresholds for who can approve expedited shipments and under what circumstances. Strike a balance between the need for quick decisions and control and visibility of excessive freight charges.

• Allocate the cost. It is not feasible in all cases, but an effort should be made to allocate the costs of expedited shipments to the responsible party, or assign penalties of some sort. In some cases this is an external party such as a vendor or carrier. In other cases it is another department in your organization. Regardless, with accurate records and root cause analysis you have all of the data necessary to assign liability. If actual allocation of costs or penalties is not possible, at a minimum the use of expedited shipments should be a key metric used to evaluate overall performance.

MANAGE YOUR PARCEL FREIGHT

For many shippers, parcel is a small part of their overall freight spend when compared to truckload, LTL or ocean freight. A great deal of effort is spent in designing solutions around the other modes while parcel shipments are relatively ignored and unmanaged. It does not help that parcel contracts can be three or more years in length, leading to a “set it and forget it” mentality with annual rate increases accepted without much thought or analysis. For U.S. domestic shippers, the effective duopoly of UPS and FedEx (with USPS a distant third) limits the effort and creativity applied to designing parcel solutions. Even high volume parcel shippers may not spend much time worrying about optimizing their freight once a carrier contract is in place.

However it is precisely because this arena receives so little attention that it can lead to significant cost reduction opportunities. Here are some things to keep in mind:

- Implement a parcel invoice audit program. Most studies indicate that 5% of parcel shipments do not meet the guaranteed service level and/or are invoiced incorrectly. Chances are that you aren’t claiming the refunds/ adjustments you are entitled to. A parcel audit program is the electronic auditing of UPS and FedEx invoices for the purpose of identifying service failures, billing errors and erroneous charges and the recovery of those charges on the shipper’s behalf. It’s your money, but you need to ask for it! Side benefits include access to detailed shipping data, the ability to apply general ledger codes and the ability to identify improper use of account codes.
- The announced annual rate increases are averages – the actual impact on your freight can vary significantly from the percentages announced by the carriers. You need to do an analysis of your freight under the new tariff, considering your specific package sizes, service levels and zones. You could find yourself paying a lot more than the announced increase.
- Many shippers try to simplify their parcel shipping by awarding their entire business to a single carrier. You will almost certainly save money by selecting more than one carrier, and if ship heavily in a regional market such as Southern California you may benefit from using a regional parcel carrier. Of course, using more than one carrier will increase your administrative burden and may require you to install multiple carrier manifesting systems or look into one of the multi-carrier systems marketing by some software companies.
- Make use of shipment and carrier optimization – either by doing analysis of shipping patterns after the fact or by implementing real-time shipment optimization. Some of the simplest methods to save money on parcel involve selecting the appropriate mode and service level for each shipment. You most likely have shipments moving by air that can be delivered by ground at half the cost.
- Consolidate shipments where possible. You may regularly ship multiple orders/shipments to a single destination. You can save 20-40% if you place multiple packages on the same waybill and talk to your carrier about their heavyweight or hundredweight services.
- Review your packaging, particularly if you are close to weight and dimensional limits. Both FedEx and UPS add significant surcharges to over-dimensional shipments. If you ship large packages you should look at other modes and services (such as LTL or pallet/heavyweight offerings), and in extreme cases you should consider changing the packaging to fit within the carrier thresholds.
- Review your historical surcharges. The total cost of parcel shipping includes a significant number of accessorial charges – more than 200 if you ship internationally. Fuel, Saturday delivery, address correction, delivery area surcharges and extended delivery area surcharges – they all add up. These extra fees can exceed the base cost of the shipment. A parcel audit program can help you identify, validate and manage these charges. Recurring charges should be addressed in quarterly meetings with carriers to determine whether they can be avoided. Address correction, for example, is usually a matter of updating your own internal systems with accurate and properly formatted addresses.
- Pay attention to your discounts. UPS and FedEx now offer discounts based on weekly gross spend across all services, rather than giving discounts by service. Because the incentives are usually based on a rolling average, the economic slowdown may have pulled you into a lower tier or even below the minimum thresholds required to maintain the incentives. This can significantly impact your transportation budget. If you have slipped to a lower tier and expect to remain there you need to address this with your carrier.

THE BOTTOM LINE

Those of you who have oversight of the transportation budget may already look like heroes without implementing any of the suggestions in this paper. After all, in 2008 we saw the impacts of $4.80/gallon diesel and tight carrier capacity. This created some very favorable benchmarks for year-over-year comparisons when many of you were setting budgets for 2009. But remember that the sword cuts both ways – if you are taking credit for running well under budget this year you should be prepared for costs to move rapidly in the other direction when the economy begins its recovery. 2009 will set up some very difficult comparables for 2010 as we see freight rates bottom out and begin to climb upward again. It would be worthwhile to remember the volatility of the freight markets when setting budgets for next year and when communicating with corporate management. Properly accounting for the performance of your freight budget may lead to fewer "kudos" in the short-term but will set you up for long-term success.

In the meantime, by going "back to basics" and implementing some of the suggestions in this paper you will not only demonstrate your commitment to corporate-wide cost management, you will also set up your organization to fully participate in the coming economic recovery.

Learn more about Spinnaker's Parcel Audit and Recovery services – www.spinnakermgmt.com/parcelaudit

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