THE INSIDE EDGE:
NEGOTIATING CARRIER AGREEMENTS

BENCHMARK VS. COST MODEL APPROACH

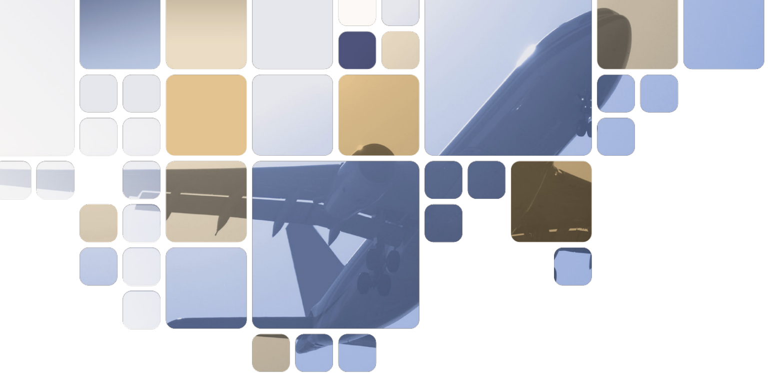
Executive Summary

Ignorance is a profit center for carriers. There—it's been said.

Getting the best rates for your company is an impossible task if you don't know what the carriers really want out of you. To put it simply, you just want a good deal and the carrier wants a good margin. But who has the advantage in contract negotiations?

The less you know about the carrier's cost and pricing structure, the less likely you are to optimize your end of the deal. To cross-compare, it's no wonder why a used car salesman will not divulge the dealership costs of that 2010 Corvette with 40,000 miles. All he tells you is that the price you're offering will create red ink on his balance sheet. Is he being honest? Who knows—unless you know what his costs were on that particular vehicle.

If you're resourceful, you can dig up benchmarked market data to create some wiggle room



in negotiations. In the used car scenario, see the Vinny app. The idea behind this negotiating tool, is that it provides prospective car buyers with negotiating leverage that they can take to car lots. The Vinny app scans a VIN number and pulls nationwide auction data on that Year/Make/Model vehicle. The ingenious result is added insight that provides a general idea as to what a dealership might pay for that vehicle.

The Vinny app has similarities to the benchmarking approach used by companies in carrier contract negotiations. The benchmark approach can provide general cost and pricing insight that makes companies more comfortable at the table and make carrier negotiations a little more favorable for the shipper. The results are generally positive. Companies save money, and they feel great about the concessions received from the carriers. But they still have no specifics as to carrier costs and, therefore, no idea how much money was left on the table. Here's a hint: it was probably a lot.

Using a cost model approach, negotiators drill deeper to understand the specifics of carrier costs relative to the company's specific shipping traits. When implemented correctly, companies save significantly more in their carrier agreements because they know the high-margin areas for the carriers as well as the margins they prefer, which translates into knowing precisely which concessions are available.

Yet, the cost model approach is rarely utilized in negotiations with carriers. It requires the right mix of experience and an insider's knowledge of the carriers' cost models and pricing structure—a knowledge not generally possessed outside the carriers' executive pricing teams.

The rest of this article will further explain carrier pricing and how benchmarking and cost modeling affects the end result of negotiations. The goal is to help with strategy development for your next contract negotiation by highlighting the difference between the two approaches and how the cost model approach can bring significantly greater results.

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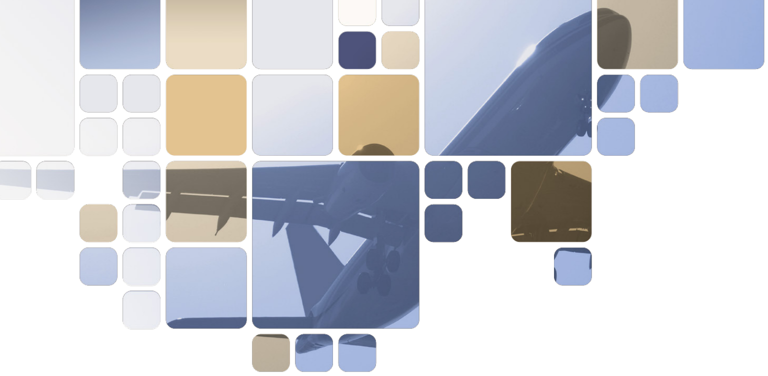


How do parcel carriers develop pricing?

Carriers evaluate each individual company's unique shipping characteristics, including sizes, weights, where they're going, where they're coming from and many other metrics. That information is weighed against the carrier's cost to serve those packages with adjustments being made to maintain desired profitability for the account. Information is key and many factors will impact what a carrier can offer. We outline three key factors below.

Size of account matters

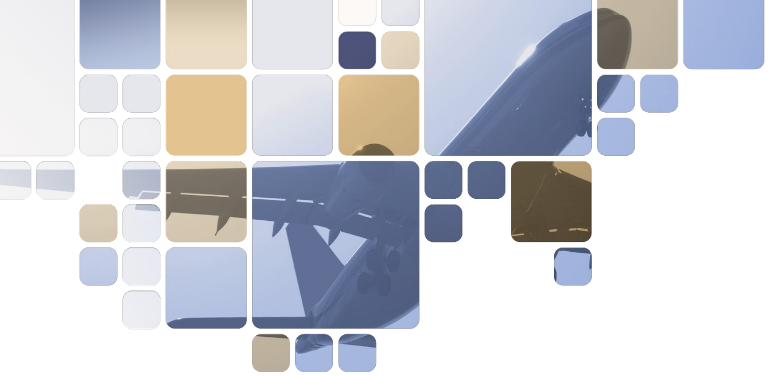
Depending on the carrier, there are multiple tiers where pricing decisions can be made. Shipping spend is usually the first factor, but ultimately, carrier margins will determine how high up the food chain final approval goes.

Small to medium-sized companies (annual shipping spend < $100K) usually receive system-generated pricing and/or a local review from a carrier sales representative. Using internal benchmarking tools, basic information is entered—such as annual spend, service type, service mix, etc—for a fast and efficient way to develop market-based pricing for a customer. Cost drivers are not deeply analyzed for smaller accounts making for a less sophisticated approach. However, a referral to corporate is not uncommon when negotiations become competitive and preferred margins are being threatened.

Medium to large companies (annual shipping spend $100K to $1 mil) undergo a more sophisticated regional, or corporate, pricing review. Carriers' pricing groups will seek additional shipping data and package-by-package details to analyze and weigh against carrier cost drivers.

Large, national and strategic accounts go straight to the carriers' corporate pricing groups. These companies usually have annual shipping spends in excess of $1 million. They can also be companies with complex shipping characteristics due to multiple locations, distribution centers and often include large, well-known brands that fit the carriers' strategic business objectives.

There are also "special case" accounts that could include any of the aforementioned. These are accounts that involve shipping characteristics or negotiating demands that exceed local authority and must go to corporate for final approval.



Analyzing Shipping Data

The key here is whether the carrier is using system-generated averages (small-medium sized accounts) or analyzing a company's package-by-package details to generate a quote. System-generated averages produce very conservative discounts and pricing. By diving deeper into shipping data, the potential exists for much greater savings. Carriers can get more aggressive with pricing because they compare package-by-package details to areas that produce more favorable margins for them.

Competitive Environment

An understated factor in carrier pricing development is the business landscape that may require adaptation, or exception to the normal thresholds of carrier pricing. For example: What's happening in a particular market across the country? Is the carrier losing business to competition? Perhaps the carrier just opened a new ground hub in the area and they need to fill initial quotas. Or maybe there's a strategic objective to gaining the business of a prominent brand with a large network capacity. These external forces can present new opportunities for companies within markets where carrier pricing groups depart from standard corporate pricing policy.

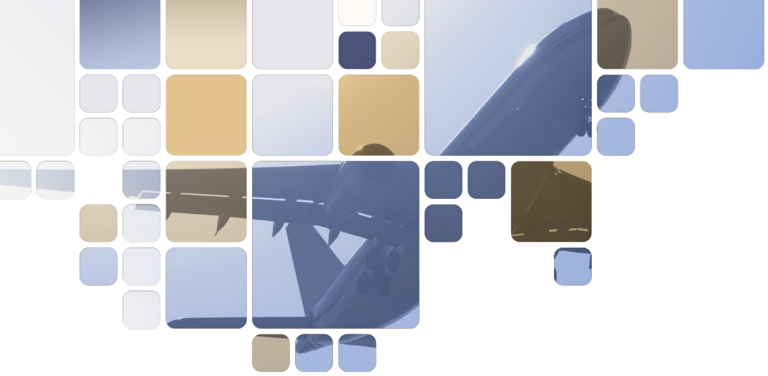
How do consulting firms develop pricing strategy?

The two primary methods of developing a pricing strategy are based on benchmarking (the most common) and based on the understanding of carrier cost models.

Both approaches are effective in achieving favorable shipping rates and both require high levels of industry knowledge and understanding of carrier pricing. Where the two approaches diverge is at the level of understanding of carrier costs.

Understanding carrier pricing vs. carrier costs is an important distinction.

Carrier pricing is well-understood by those with enough industry experience. A longer career in logistics and negotiating carrier contracts provides a deeper frame of reference to carrier pricing. It's the principle of 'the more you see, the more you understand,' which is why 3PLs and other contract consultants market their industry experience so heavily. They know and understand the going market shipping rates, and therefore, know what discounts are obtainable for your company. This focus on current market rates and average discounts is the crux of the benchmark approach.



Benchmarking is a weighted average.

Benchmarking is a simplistic analysis that compares a company's shipping spend, shipping volume, its size and industry against what has been "seen" for companies with similar shipping profiles. While it focuses on dollar amounts, volume shipped and discount percentages, it ignores—in large part—language and structure of agreements, which can vary greatly from company-to-company based on shipping characteristics and corresponding carrier costs. Although benchmarking provides a comparatively quick-and-easy negotiation cycle, this usually means shippers are not getting as detailed as they should with their agreement.

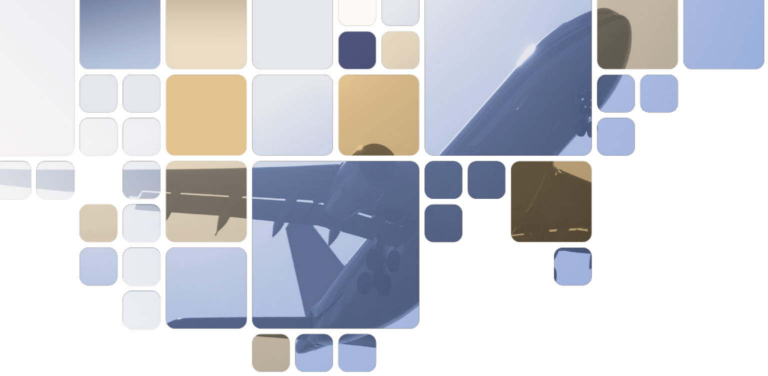
Failing to drill down into specific shipping traits can create problems for companies under a benchmark approach. Benchmarking a company with divergent shipping characteristics can lead to ill-informed feelings of entitlement when Company A isn't offered the same percentage discounts as Company B. Company A's packages might have less favorable delivery densities or size-to-weight ratios, which warrants different pricing considerations from the carriers. Company B might ship a majority of its packages on 2-Day air and Company A might ship far less, if any at all, in this mode. Nevertheless, when carriers refuse to give Company A the same deal, a contentious back-and-forth often ensues where one of the parties walks away feeling like a loser.

Myth: The more you ship, the better your discounts.

Because benchmarking focuses on volume and discount percentages, rather than package-by-package details, Company A is unable to adequately determine the viability of concessions relevant to its shipping profile. One of the biggest misconceptions in the world of shipping—which is fed by the benchmark philosophy—is that the more you ship, the better your discounts. The truth is, once Company A hits around $100,000 in shipping spend, the volume becomes a much smaller factor in determining rates. At this point, the best deals result from taking a deeper look at shipping characteristics and determining how they line up against carrier cost drivers.

Cost modeling resolves variable shipping characteristics.

Package-level detail is key! Companies discover dozens of additional concessions throughout negotiations by examining their shipping characteristics and weighing their "uniqueness" against their knowledge of carrier cost drivers. And more concessions on the table provides more collaboration and a stronger business partnership between the two parties.



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Cost modeling requires an in-depth understanding of what drives cost for carriers. More than knowing the carrier's cost to ship from Point A to B, it means knowing where the carriers have the highest margins and the amount they are able to concede in order to maintain profitability.

With the primary objective to maximize concessions from both sides, the "total package" cost-modeling analysis looks at the company's shipping characteristics, the carrier's cost drivers, language of the agreement and its structure as well as discounts available. This is beneficial to both parties because the shipper maximizes savings and the carrier concedes in areas they can afford, while not getting beat up over an area they couldn't.

If it's so great, why doesn't everyone do it?.

A true cost model approach is scarcely implemented in carrier contract negotiations. As you've probably figured, knowing the specifics of carrier cost drivers is not simply "picked up" with time spent in the industry. Many contract consulting firms advertise a team member as a former pricing person for a prominent carrier. You'll inevitably find out that he or she was a local or regional pricing representative or operations executive who lacks top-down knowledge of the carriers' actual costs relative to package-by-package shipping traits. This is safe-guarded information that is not handed down from the carriers' top-level corporate pricing executives. In reality, there might be 5-10 individuals inside the carriers' elite pricing teams who have this knowledge, which makes it virtually impossible to find someone in the consulting space with true cost model knowledge. But they are out there.

Regardless of industry, having knowledge of a seller's preferred margins, areas with the highest margins, and the minute details of cost drivers is a tremendous negotiating advantage. Although the shipping industry standard is still benchmarking, companies do not have to limit their agreements to a one-size-fits-all approach.

Nothing here is to say that benchmarking is a terrible thing. It's actually very sound and a great kick-off to negotiations. But there is a better strategy that creates a lot more value for shippers. So, rather than seeing the two approaches as 'good vs. bad,' try to view it as a continuum of 'good, better, best.' For companies that are ready to renegotiate their carrier agreement, it will be worth their effort to explore the benefits of the cost model approach.

For more information about cost modeling or carrier contract negotiation strategies, please call 888.797.0929 or visit idrivelogistics.com.