Rethinking Parcel Spend:

Developing Strategies to Reduce the Impact of Peak Surcharges

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Over the last several years, parcel shippers have seen general rate increases of up to 5% annually from FedEx and UPS. Last year, dimensional weight pricing added to the burden of rate increases. This year, carriers upped the ante with peak surcharges on top of annual increases. Every year, supply chain leaders are struggling with the impacts of the increases and looking for strategies to minimize the effects of rising transportation costs, especially during peak season. To help make sense of the changes and provide insights on what to do about them, we sat down with parcel industry experts **Rob Martinez, CEO at Shipware** and **Rich Jenkins, strategy manager at Fortna**.

In this article, we will focus on trends within the parcel industry, newly implemented peak surcharges and provide recommendations from industry analysts to manage rising transportation costs. Understanding that choices made within the four walls can also have a significant impact on parcel spend, we will follow-up with what can be done within the distribution center process in order to mitigate increasing transportation factors that drive up spend.

Recently parcel carriers added surcharges for peak deliveries. What are the changes and what is the reasoning behind them?

Rob: UPS has implemented a new surcharge for residential deliveries for peak days throughout the year, including the upcoming holiday peak. While UPS has not yet extended the peak surcharges to other holidays outside Christmas, FedEx has been clear that this is a peak surcharge, not simply a holiday surcharge. Meaning that Valentine's Day, Mother's Day and other holidays will also be affected by the surcharge. The reason behind the peak surcharge is that parcel carriers incur significantly higher costs during peak times due to the increase in volume. For instance, UPS experiences close to a 2-to-1 ratio increase in volume between Thanksgiving and Christmas. Due to the increase in volume and service requirements caused by the rise in eCommerce, carriers have had to make major infrastructure investments in recent years. This resulted in significantly higher operating costs and carriers are simply passing these costs off to shippers. UPS and FedEx have both had to create new sort capacity within their facilities and feel it's fair to pass on costs to customers.

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Rich: While peak volumes have always been a challenge to logistics providers, the shift to eCommerce has shortened the peak transportation window significantly. In the past, some of peak was smoothed out as the inventory buildup at DCs and stores happened well before the consumer rush. In a post-eCommerce world, there isn't as much pre-positioning of inventory to take volume off carriers during peak. The bottom line is highly seasonal shippers simply cost more to serve as carrier operations approach and exceed capacity during holiday periods. The new surcharges align UPS' pricing more accurately with the true cost to serve and may even lessen peak's impact on annual rate increases in the future. It is fundamental for shippers to understand that this is not simply an end-of-year surcharge, rather that they will be faced with these charges at peak times throughout the year.

How is the market reacting to the surcharge and what can companies do to minimize the effects?

Rob: Overall, shippers are pushing back hard. This past September, I held a workshop at the Parcel Forum in Nashville with a group of large- and medium-sized shippers where I polled the group to find out what they are doing in terms of the recent increases. The results varied, but 75% of the participating shippers were actively seeking negotiations, and approximately 20% have worked with UPS to defer the increase to 2018. Others have received a contract waiver, concessions, discount percentage off the accessorial, etc. To minimize the effects of increases, I would first recommend attempting to renegotiate rates. Then consider implementing an audit process for carrier invoices and exploring the option of utilizing the U.S. postal service or a regional service.

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Rich: Shippers naturally resist ANY rate increases so it's likely that parcel carriers will be on the defensive and playing fairly gentle with implementation of the surcharges for now. There are some opportunities for negotiation, but we expect them to be short-lived. You can expect other parcel carriers to seek protection from shippers attempting to off-load a higher proportion of low margin seasonal volume as a way to avoid UPS peak surcharges. The industry will be watching to see if UPS is able to show a significant volume decrease while protecting their peak margins. If they do, then competitors will likely follow suit with their own surcharges.

There are a number of strategies to reduce the impact of peak surcharges:

One strategy is to leverage the entire distribution footprint including vendors, stores, 3PL, carrier terminals, ports, etc. Every touch point has the potential to create bypass relief as well as cost and service improvements by supporting cross-dock, break-bulk or critical parts storage, whether year round or seasonal. This is especially useful during peak when operations hit capacity limitations. There may also be seasonal, low-tech alternative flow path options that provide the needed relief during peak season. This can also offer significant cost savings by consolidating long multi-zone shipments or vendors drop shipping closer to point of demand.

Consider allowing regional carriers, private/dedicated fleets, local couriers, etc. to take on expanded seasonal roles. To take advantage of opportunities to offload volume or even swap carriers when volumes, loads and rates make it favorable to do so requires a shipping process that is carrier neutral. This kind of operational flexibility comes when the shipper, rather than the carrier, controls the systems and equipment that handle work flow, routing, order logic and manifesting for outbound.

Ways to Reduce the Impact of Peak Surcharges

Here are just a few of the strategies our experts recommend to help reduce transportation spend in light of recent peak surcharges.

1. **Negotiate your rates** – Understand everything in a contract is negotiable, from newly implemented surcharges to dimensional weight.
2. **Understand your data** – When entering into negotiations, know your data. Understand what surcharges and fees matter to you. There are over 80 specific surcharges, but you need to understand which ones are important to you. Pull your own data or ask carriers for a summary of it.
3. **Identify and isolate disruptors** in your fulfillment process to improve order processing cycle time.
4. **Look for ways to smooth out peaks overall**.
5. **Leverage your entire footprint** including vendors, stores, 3PL, carrier terminals, etc. Every touch point has potential to create bypass relief and service improvements.
6. **Consider a regional carrier strategy** – There are many advantages to using USPS. They have lower rates and no surcharges.
7. **Take advantage of TMS** for dynamic routing.
8. **Audit carrier invoices** – Develop an audit invoice strategy and be consistent.
9. **Evaluate zone skipping** to improve transit times and lower transportation costs.

Finally, look for ways to make your carrier partner an ally rather than an enemy. In discussions regarding surcharges, ask what can be done to lower their cost to serve and provide additional flexibility. For example, can selected sensitive zip code ranges be segregated to provide bypass relief to your local carrier operation? That could reduce cost, improve service, and potentially extend your ordering window with later pull times from your DC. Ask your sales rep to bring an industrial engineer to the table to help identify these potential win-wins.

What are some of the trends you seeing in the industry? In addition, what are shippers focused on to stay competitive?

Rob: A few of the big trends we're seeing this year are 'Ship from Store' programs, a focus on front-end shipping fee transparency, and carriers developing an access point network.

First, bricks and mortar retailers are exploring 'Ship from Store' programs as a way to keep pace with 2-days shipping trends. Shippers realize they cannot compete shipping from their DC's anymore and that they need to utilize their retail footprint to remain competitive.

Another key trend is front-end shipping fee transparency. Shippers are starting to realize that consumers are more empowered than ever and they want to make their own decisions. Recent studies show that consumers want choice and visibility. Shippers are developing ways in the shopping cart to estimate fees earlier in an effort to minimize cart abandonment.

The third trend is one for carriers to create higher delivery densities through access points. While FedEx and UPS access points offer greater customer convenience, access points significantly reduce operating costs by consolidating multiple residential deliveries to a single location. A perfect example of this is FedEx's recent partnership with Walgreens. They are developing a network of delivery centers in commercial centers to improve the last mile delivery.

Rich: A key trend in the retail sector is being driven by growing consumer expectations for free and fast shipping. When determining the right mix of DC's and secondary fulfillment capabilities to meet both eCommerce and traditional demand, we are seeing more creative use of secondary facilities and even larger stores functioning as mini DCs for selected geographies and products. Clients are looking at the potential for pop-up DCs in urban areas and leveraging closed or "dark" stores as cross-docking, mixing center and parcel zone facilities.

Best-in-class supply chains are rapidly enabling omni-channel capabilities to allow buy anywhere, fulfill anywhere operations. Ship-from-Store and Buy Online, Pickup in Store (BOPIS) are being investigated to allow shorter order-to-delivery cycle times for customers, without multi-tier handling delays and costs. This is a complex analysis as the cost of inventory, space and labor in the extended supply chain must be considered alongside expectations for service improvement and revenue lift.

In addition to network strategy opportunities to lower cost and time to serve, there is a growing trend toward creativity in transportation mode selection and last mile execution. Clients that operated successfully for years with one or two modes (parcel/LTL, TL/parcel) are now actively investigating alternative modes including intermodal, fleets, local couriers, and in well publicized experiments by Walmart and Amazon, crowd-sourcing deliveries through employees. Companies are able to take advantage of multi-modal opportunities now that Transportation Management Systems and dynamic routing capabilities needed to effectively execute complex transportation operations are available through "software as a service" models with lower barriers to entry. And cooperative agreements enabled by 3PLs allow compatible companies to share space to reduce waste and increase consolidated movements.

Rob Martinez, DLP

CEO & Co-Founder

Rob Martinez is the CEO & co-founder of Shipware, and has been in the parcel industry for nearly 30 years: a decade on the carrier side, and since 2001 in his current role as a leading consultant to some of the most recognizable brands in the world. Rob is widely considered one of the premier thought-leaders in parcel, and has been designated a DLP – or *Distinguished Logistics Professional* – for his career-long contributions to the industry.

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Rich Jenkins

Manager, Supply Chain Strategy

Rich Jenkins is a manager in Fortna's Strategy Practice, with more than 30 years of experience in the supply chain and logistics industry including engineering, operations, and strategy in carrier, 3PL, shipper, and consulting domains. He holds a Master of Science in Industrial Engineering, an MBA, and Bachelor of Science in ME/Operations Research and has an extensive background in optimization and held previous positions with UPS, Exel and iXL.

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