

PRICING FOR PROFITABILITY

(or don't blame the shippers)

THE LESS-THAN-TRUCKLOAD industry is facing numerous challenges to achieve growth and profitability. The most common concerns cited are overcapacity and too many large competitors. Yet none is more critical to the industry's prosperity than its badly broken pricing structure.

Since trucking deregulation in 1980, the LTL industry has had the worst performance in terms of top-line growth and bottom-line profitability compared to parcel and truckload segments. Over the past 25 years, the parcel industry has grown at a 7.1 percent average annual rate, and the truckload industry has grown at a compounded annual rate of 2.7 percent, while the LTL industry has lagged behind at 2.2 percent.



■ By Satish Jindel

IN TRUTH, THERE IS NO UGLY FREIGHT, ONLY UGLY PRICING.

Even in the recent third quarter, while carriers have claimed increases in shipment volume and pricing power, the average operating margin for the publicly held LTL carriers was less than 1 percent. By contrast, the truckload carriers achieved 7.1 percent in the same period and the parcel carriers realized an average 11 percent operating margin.

Although the private LTL carriers did better, the entire LTL industry struggles to generate consistently high single-digit margins because of an outdated pricing structure.

LTL pricing has remained unchanged since deregulation, even with numerous changes in products and shipment characteristics and in customer supply chains. The current structure relies heavily on deficit rating and the classification system. Using the current deficit rating system, a shipment weighing

980 pounds moves at the same total shipping charge as one weighing 780 pounds. Hence, either the pricing for the 780-pound item is too high or pricing for the 980-pound is too low, resulting in a situation where some shippers and shipments subsidize others.

This pricing deficiency also leaves LTL shipments subject to diversion to other competitive segments: Lightweight LTL shipments are lost to parcel carriers' hundredweight service and heavier shipments to the truckload carriers. While the LTL industry market based on revenue of LTL carriers for 2010 will amount to about \$28 billion, the market size for all shipments moved as LTL (that is, shipments between 150 and 1,000 pounds) totals \$38 billion. The \$10 billion difference is for lightweight shipments lost by LTL carriers to the parcel carriers and for heavier shipments lost to truckload carriers.

The other major aspect of LTL pricing deals with the freight classification system maintained by the Commodity Classification Standards Board. The system was established to classify products based on characteristics such as density, stowability, handling and value. Hence, more than 11,000 different products are categorized under 18 freight classes.

The LTL pricing structure does little to reward shippers with better crating or packaging practices. For example, an engine strapped on a pallet is priced the same way as one that is properly crated.

Clearly, there is a huge difference in the handling and transportation cost of both shipments. Yet although the National Motor Freight Classification lists a crated engine as Class 70 and an uncrated one as Class 85, the difference in shipping charges are less than \$15 — no real incentive for a shipper to crate and get billed at Class 70. In comparison, parcel carriers apply a surcharge of \$8 per package

for products shipped without proper packaging in a brown box.

Other freight transportation segments focus on extensive details about the actual product transported and base pricing on the characteristics of the shipment. Simplification of LTL pricing can start with unbundling of the valuation from other shipment characteristics.

Parcel carriers have already done so. The hundredweight services of UPS and FedEx have removed the valuation component from a tier approach, which converts 18 NMFC classes into eight tiers. More importantly, the valuation for the shipment for damage or loss is the same as that for an individual parcel, at a maximum of \$100 per parcel. Shippers with more valuable products can purchase higher declared value coverage for a separate charge.

The result of working with a dated pricing structure is that LTL carriers that lack good costing and pricing applications are unable to determine which customers and shipments generate what level of profitability. So even when one LTL carrier may have precise pricing applications, the lack of such capability among other carriers results in poor pricing for all. Hence, the term "ugly freight." In truth, there is no ugly freight, only ugly pricing.

Parcel carriers have the technology to capture the dimensions of every package, so look for them to leverage that capability with their LTL subsidiaries. Failure by LTL carriers to modify their pricing structure by modifying the classification system or developing a new structure will expose those carriers to further market erosion and limit their profitability. **joc**

This is third in a series of five commentaries on LTL trucking. Satish Jindel is president of SJ Consulting Group, with offices in Pittsburgh, Pa., and India.