PARCEL *VS.* LTL

■ *By Satish Jindel*

AS TRUCKING EMERGES from the recession, many less-than-truckload carriers are struggling to rebuild. But those LTL truckers had razor-thin profit margins even before the downturn. To truly break out of a low-profit, slow-growth model, LTL companies need to get in the same fast lane as the parcel companies.

Since 1983, LTL trucking has grown at a compound annual rate of just 2.2 percent, while the parcel industry, led by FedEx and UPS, had a CAGR of 9.1 percent.

One way to understand the reasons for such a difference and what the future opportunities might be for LTL trucking is to compare FedEx Ground with Con-way Freight. Both companies are products of trucking deregulation in 1980, with Con-way Freight, then called Con-Way Transportation Services, established in 1983 and FedEx Ground, originally Roadway Package System, in 1985.

FedEx Ground generated $7.4 billion in revenue and more than $1 billion in operating income in fiscal 2010 ending May 31. In the first quarter of the new fiscal year, it had an operating ratio of 85.4. In contrast, Con-way Freight had $2.9 billion in revenue in the last four quarters and operating income of just $40 million. It had an operating ratio of 97.9 in the second quarter.

While there are major differences in the competitive landscape of parcel and LTL, that alone doesn't explain why LTL profit margins are so much thinner than those in the parcel industry. For one, public LTL carriers such as Old Dominion Freight Line and several private ones achieved better operating margins than Con-way in the last few quarters through more disciplined sales, operational changes and targeted investment in technology.

Instead, the broad gap between parcel and LTL profit margins primarily results from four factors within the control of each segment and individual carriers: how they bill customers, determine pricing and use equipment and technology.

First, let's look at billing. While Con-way Freight and the LTL industry still rely on shippers to provide a correct weight and classification for the shipment, FedEx Ground and the parcel industry capture and bill based on the true weight and cubic dimension of every package.

The flaw in the LTL method becomes clear when carriers reweigh shipments, find they are heavier than they were told and try to charge shippers for the difference. When a shipper objects, carriers often are quick to waive corrections for fear of losing the account. The LTL industry is losing a few points of its operating margin to this shortcoming in billing.

Second, LTL carriers have clung to an antiquated pricing structure. The parcel carriers handle millions of parcels daily and even multiple parcel shipments weighing 1,000 pounds using a simplified structure with one common rate table. LTL carriers, however, have numerous rate tables — even some developed by shippers to be used exclusively by all carriers that wish to handle their shipments.

The result: Many LTL carriers, particularly those lacking good costing and pricing methods, can't establish profitable pricing by shipment and customer. Even when other LTL carriers have better pricing capability, the lack of it among competitors leads to widespread unprofitable pricing in the industry.

Third, FedEx Ground saw opportunities to take heavier and larger packages and led the industry to increase its maximum weight from 70 to 100 and then to 150 pounds. To profitably handle such shipments, it deployed straight trucks and tractor-trailers in its pickup and delivery operation. In contrast, the LTL industry is handling an increasing number of smaller shipments. Even with an average shipment weight of about 1,200 pounds, almost 70 percent of all LTL shipments are less than 1,000 pounds and about 50 percent are below 500 pounds. Yet, with so many lighter and smaller shipments, the LTL industry has been reluctant to park 53-foot tractor-trailers used for local pickup and delivery operations. LTL carriers that deploy straight trucks on many routes are generating higher margins.

Fourth, Con-way and FedEx Ground invested millions in technology, but the devil is in the details. After more than a decade of such investments at Con-way, perhaps 20 percent of its LTL shipments are received using an electronic bill of lading. FedEx Ground receives more than 95 percent of all packages via electronic manifest.

The gap is even more startling when applied to the whole industry. While the LTL industry handles 620,000 shipments a day, the parcel industry handles more than 25 million daily parcels — 40 times more shipment volume. Gaining advance knowledge of shipments electronically to create loads for better line-haul trailer loading and dispatching gives FedEx Ground and the other parcel carriers a cost advantage.

With line-haul representing about 25 percent of total operating costs and a major element in on-time performance, the parcel carriers and FedEx Ground gain a significant advantage in attracting shipments that traditionally went to LTL carriers.

The LTL industry also can achieve double-digit operating margins but only if it adjusts business practices to suit new market dynamics. **JOC**

This is the first in a monthly series of commentaries on LTL trucking. Satish Jindel is president of SJ Consulting Group, with offices in Pittsburgh and India. Contact him at satish@jindel.com.