

By Satish Jindel

PFT Provides UPS a \$1 Billion Payback

When UPS announced its package flow technology investment in 2003, it justified the \$600 million capital expenditure largely from operational cost savings. The \$600 million projected annual savings would come from operational areas such as preload, fuel consumption and driver productivity. The company would not comment on the revenue and marketing benefits of the technology.

However, its two recent air service announcements would have been more difficult to achieve without the deployment of PFT:

Expansion of Early AM ZIP codes from 12,100 to 19,300 and with varied commitment times that now extend up to 10 a.m.

Change in 2nd Day Air AM service commitment time from noon to 10:30 a.m.

How are these initiatives influenced by PFT and why do they represent market advantages for UPS?

In addition to increasing productivity of preload operation, PFT has helped cut down on the number of package handlers needed and can complete preload earlier to get drivers on the road sooner. The driver productivity improvement helps get deliveries completed earlier in the day which is being leveraged with changes to Early AM ZIP codes and the Second-Day Air AM service.

With incremental revenue of \$28.50 per package for Early AM over Next Day Air, any conversion to premium service improves margins for the express segment.

Similarly, the package volume handled for Second-Day Air AM service would not qualify this service as a major success. This partly due to the noon commitment, which represents a hurdle for value proposition. Airborne recognized this difficulty with its Express service. After years of promoting the noon commitment of its overnight service being as good as the 10:30 of competition and a better value at lower rate, Airborne (now DHL) finally had to introduce a 10:30 a.m. service. While the competition in focusing on margin improvement for the 10:30 a.m. service, UPS is enhancing Early AM service in stages that are likely to surprise competition when fully rolled out.

The change in 10:30 a.m. service is long overdue. First introduced in 1984 by FedEx, it has remained largely unchanged for more than 20 years.

With the once-exclusive guaranteed delivery and tracking/tracing visibility now available for ground service, express service been cannibalized, particularly in short zones. As these two air service changes unfold to full potential, UPS will achieve a gradual change in the express service that will position the company for better returns against the guaranteed and improved ground service.

For shippers, these two changes have different implications.

First, most shippers will be surprised to find more ZIP codes now qualify for Early AM service than Next Day Air 10:30 a.m. delivery commitment. Of the approximately 41,600 ZIP codes in the United States, Next-Day Air service by 10:30 a.m. is offered to only 17,000, with noon commitment to 8,700 ZIP codes and 4:30 p.m. commitment to the remaining 15,900 ZIP codes.

Hence, shippers can now get earlier delivery time of 10 a.m. to some 5,000 ZIP codes that otherwise have Next-Day Air commitment time of noon. However for a half-hour earlier delivery to these 5,000 ZIP codes with noon Next-Day Air commitment, shippers should expect to pay \$28.50 in addition to the charge paid for 10:30 a.m. next-day delivery.

The changes to Early AM and Next-Day Air services are likely to drive more volume from Next-Day Air to Early AM. However, similar developments for Second-Day Air AM service will be more difficult as a result of upgrading the noon commitment time to 10:30 a.m. If this change does not energize the Second-Day Air AM service, expect UPS to either eliminate the Second-Day Air or Second-Day Air AM.

For UPS, adding 10 a.m. Early AM service to noon Next-Day Air points provides a higher yield than it would get from upgrading noon points to 10:30 a.m. The higher yield recovers the increased cost of reaching these additional ZIP codes earlier in the day.

Some may argue these changes could have been implemented without package flow technology, which could be true if the company handled a few hundred thousand packages per day with a few hundred routes and limited service levels. However, to manage more than 10 domestic services and international ones for more than 13 million packages per day handled by more than 70,000 drivers with high on-time service measures, PFT provides the process and structure necessary to manage the complexity of daily and weekly changes in volume by service type and delivery destinations.

PFT not only gives UPS an opportunity to change ZIP codes and commitment times, but allows for periodic adjustments, making it a dynamic service offering that can change as rapidly as the customers supply chain does and makes it harder for competition to match UPS service offerings.

We estimate the cost savings to UPS from PFT to be \$750 million per year starting in 2008. In addition, PFT is creating opportunity for UPS to generate several hundred million dollars through enhancements in service levels and differentiation in express and ground services. In all, the combined benefits of PFT to UPS could exceed \$1 billion per year.

Satish Jindel is president of SJ Consulting Group, based in Pittsburgh.