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PRICING VALUE

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IN 1985, UPS had revenue of $7.7 billion. In fiscal 1986, Federal Express topped $2.5 billion. RPS, which would become FedEx Ground, had just started. Shipping a 12-pound package 600 miles cost $3.31.

In the less-than-truckload sector, Yellow Freight and Roadway Express, two of the industry's Big Three, each finished 1985 with $1.4 billion in revenue. American Freightways, the predecessor to FedEx Freight, had revenue of $25 million. It cost $130 for a shipment moving 1,200 miles.

Much has changed over the last 25 years. UPS generated $49.5 billion in revenue last year, and FedEx revenue totaled $39.3 billion in fiscal 2011; FedEx Ground reported revenue of $8.5 billion. The same package today costs $8.13.

Yellow and Roadway have merged into YRC, with revenue of $2.6 billion in 2010, and FedEx Freight is now the market leader with revenue of $4.4 billion.

In 2011, to move the same 950-pound shipment 1,200 miles, shippers now pay $220. So, parcel carriers have seen a 145 percent rise in rates during the same period in which the LTL carriers have seen a 70 percent increase.

Comparing the parcel carriers to LTL carriers shows a disparity between rate charges and yield increases, even over a shorter period. From 2000, applying company-reported general rate increases for ground parcel leads to prices 56 percent higher, while reported yield increased 28 percent, or half the GRI.

For LTL, GRIs would cause prices to be 87 to 98 percent higher in 2011 than in 2000, with yield rising 25 percent, or one-third of the GRI. Despite a faster increase in tariff rates, yields — including fuel surcharges — for LTL carriers haven't increased as rapidly as those of the parcel carriers.

The differences between the pricing practices begin with how rate increases are applied. For UPS and FedEx, most customers under contract are subject to the GRI, with some large customers paying a portion of the GRI and a select few handled during contract renewal talks. To avoid an annual rate increase, shippers must renegotiate a greater discount to offset the GRI.

For LTL carriers, the GRI only applies to customers on general rates; customers under contractual rates are exempt. LTL carriers must negotiate their rate increases for each customer under contract, or around 70 percent of its revenue base. The result is a reversal of negotiating power; shippers go to parcel carriers for rate discounts, while LTL carriers go to shippers for rate increases.

Part of the strength of the parcel carriers' results comes from adherence to minimum charges, by changing rates individually for all weight and zone combinations and by keeping the published rates as the basis for nearly all contracts. With the minimum charges, the $5.17 rate for a one-pound, Zone 2 ground package is 71 percent higher in 2011 than in 2000 (vs. the 56 percent GRI increase) and more than 300 percent higher than the $1.23 charge in 1985.

By increasing the minimum rate faster than the GRI, which is supported by a high fixed-cost structure, parcel carriers capture a larger revenue increase. LTL carriers also maintain minimum charges, but they are often discounted in customer contracts, while parcel carriers discount rarely.

LTL carriers also have set expectations for offering discounts on GRIs. Parcel carriers discount GRIs with large customers, but to a much smaller extent. Consider that most LTL carriers announced GRIs around 6 percent three times between January 2009 and December 2010, while industrywide yield (excluding fuel surcharges) fell about 3 percent over that period.

In addition, the announced price increases don't reflect LTL cost increases. Excluding rising fuel costs, which are offset by surcharges, operating expenses changed minimally between 2009 and 2010, far below the combined 19 percent increase of the three GRIs.

During the same period, parcel carriers implemented GRIs of 4.9 and 5.9 percent for ground service and had a slight increase in yield. UPS's domestic parcel costs rose more than 3 percent over the two-year period, excluding fuel, which is more aligned with the GRIs.

The emergence of brokers is another reason LTL yield increases are below what GRIs suggest. Two of the largest LTL brokers, C.H. Robinson and Echo Global Logistics, recorded 2010 LTL revenue of around $900 million and $190 million, respectively. A decade ago, LTL brokerage was nonexistent.

Faced with high GRIs year after year, small shippers have flocked to brokers to obtain lower rates than the shippers would obtain directly from the carrier. As a result, a few hundred brokers are selling LTL services, accounting for 15 to 20 percent of LTL revenue.

By offering brokers a higher discount, LTL carriers have seen revenue decline from their most profitable customer segment with small shippers switching to brokers. As such, the greater buying power of brokers has caused LTL yields to deteriorate.

The different competitive environments and pricing practices of parcel and LTL highlight the need for rational pricing structures. GRIs should cover increases in costs, such as employee wages and benefits, across all shippers. Discounts on tariff rates then can focus on rewarding shipping attributes (such as shipping volume, freight class, etc.) that lower carrier costs.

It's encouraging that a few large carriers have taken the lead to increase profitability. Con-way is letting go of unprofitable business, and FedEx Freight recently reported its fiscal first quarter yield excluding fuel surcharges rose 6 percent from the previous quarter. Improving price retention or implementing new pricing methods in this environment will allow carriers to reinvest in equipment and technology and improve service for shippers. JOC

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