Exploring the Future of U.S. LTL Motor Carrier Pricing

Industry experts discuss current and future trends in pricing strategies.

By Joe B. Hanna
he U.S. transportation industry is under intense economic pressure, compounded by the demands of increasingly integrated global supply chains and growing concerns about less-than-truckload (LTL) capacity. To discover how the U.S. LTL industry is adapting its pricing strategies—and best approaches for pricing future LTL freight in the global supply chain—Auburn University recently conducted an in-depth qualitative/quantitative research study exploring LTL pricing through the eyes of dozens of shippers, carriers, and third-party logistics providers (3PLs) called “Synergic Pricing in the LTL Industry.”

Our study follow-up panel—convened by WT100 in September 2011—sought LTL experts’ thoughts on the issues surrounding LTL pricing. In the following Q&A, our panelists discuss pressing topics such as the increase in class-based price manipulations and discounts; the future of density-based pricing and restructuring or re-indexing base rates; the value of a benchmark pricing standard; the importance of coming to workable pricing agreements; and the best course for the future of LTL pricing as the U.S. strives to become a truly integrated global logistics player.

**Hanna (Auburn):** What do you envision as the best pricing methodology for the LTL industry?

**Manning (CHR):** Ideally, it will be a pricing mechanism that pays for space used on a given piece of equipment. As we become more of a global economy, density pricing is more in line with transportation pricing used by modes like ocean and air. The difficulty is in automating the [density pricing] process, as well as transitioning shippers who have the National Motor Freight Classification (NMFC) system embedded in their systems. NMFC accounts for differing levels of cargo liability and allows for varying rates based on cargo liability levels, so a density pricing model may also force some cargo liability standardization.

**Burroughs (UPS):** Anything we can do to make it easier and simpler for the customer—and be fair to both customers and carriers—is the way to go. NMFC is not simple. I believe the small package industry is an example of simple, yet fair. In the LTL industry, shipments come in a wide array of shapes and sizes, perhaps more than in package shipping; however, all the LTL industry would need to require [from the customer] would be the width, length, and height of each handling unit. This should be pretty simple.

**Dove (AAA):** The current classification-based pricing system takes into account major density, stowability, packaging, and value factors. However, density is certainly the most relevant factor in most costing/pricing systems. A density- or cube-based pricing methodology would certainly be welcome, as long as shippers, 3PLs, and carriers all provide accurate freight characteristics information.

There would also have to be a unity of understanding about how freight must be packaged and the liability that should be associated with each density. In a density- or cube-based system, carriers would know exactly the amount of room a product should take up within a trailer, and this could help us to better utilize equipment.
and provide for better operational planning.

**Dolan (PBS):** The best pricing methodology for the LTL industry allows carriers to provide a service and cost that enables sustainable freight movement. In either the current pricing [environment] or a density-based environment, both carriers and shippers will negotiate discount costs to reflect favorable freight and networks to their mutual benefit.

**Slaton (SMC):** The cost of providing LTL transportation is systematically addressed in today’s NMFC system and the related class-based pricing used by the U.S. LTL industry. The challenge of current LTL pricing is the [class] system structure has been undermined by endless price manipulations, including discounting off the base rates and freight all kinds (FAKs). So the challenge to the industry is this: how do we recalibrate the system and allow shipment cost characteristics to realign with a more accurate pricing model? Any new model would be accountable to the same cost drivers, so we envision a “transitional pricing change” that is implemented slowly and evolves in the market.

**Hanna (Auburn):** In our 2011 “Synergic Pricing in the LTL Industry” study, we discovered that almost 70 percent of shippers and 50 percent of 3PLs use a benchmark pricing tool to help them prepare to negotiate with their carriers. What do you perceive to be the reason for this popularity?

**Manning (CHR):** Benchmarking LTL can be very difficult. While many shippers and 3PLs use base rates for benchmarking, they do not always correctly reflect a carrier’s operating costs. 3PLs use tools that reflect hundreds of shippers and millions of dollars of freight spend. However, even with this tool, when you bring into account shipping lanes, customer requirements, shipment size, length of haul, and density, it makes it very difficult to understand if one shipper is buying LTL service at a better value than another. Shippers and 3PLs need a way to normalize the data to better understand their own cost structure, optimization, and routings.
Dolan (PBS): Pricing volatility in LTL markets and the varying service levels provided by carriers challenge shippers to accurately compare the offerings of LTL transportation providers. Using a request for proposal (RFP) tools such as SMC3 BidSense gives shippers a holistic view of the carrier landscape, enabling better shipper-carrier marriages, because network optimization between the two typically yields advantageous pricing and desired service.

Slaton (SMC3): Many industries depend on benchmarking to create standards for pricing and simplify business processes. Shippers and 3PLs in the LTL market believe that use of a base rate standard levels the playing field for carrier sourcing and RFP projects and brings accuracy and efficiency to basic business activities such as planning, analysis, financial transactions, and effectively managing change. Once a base rate is implemented, shippers and 3PLs can manage carrier sourcing with stability and a long-term vision that is not impacted by the short-term volatility of individual carrier pricing systems.

Burroughs (UPS): Larger customers who use multiple carriers often prefer a single base rate tariff to simplify the routing of their freight, so all they have to consider is carrier discounts. However, I think the need for this is changing as more and more technology is introduced in the marketplace to allow customers to compare rates with carriers on a shipment-by-shipment basis.

From a carrier perspective, it complicates the pricing in that the carrier often has to price (discount) differently on each lane or to each destination, based on their cost to serve a particular route. Logistics managers have become more sophisticated and are looking to minimize their company’s spend by using new technology. These tools allow them to rate-shop to minimize their costs. Inconsistent LTL discount strategies and cost allocation methods have resulted in widely varying pricing in each lane, and shippers are capitalizing on this by comparing rates continuously.

Dove (AAA): Shippers and 3PLs want to compare apples to apples. Benchmarking through a single base rate is the easiest way to do this—using SMC3 CzarLite base rates, for example. While this approach benefits the shipper and 3PL, the carrier is at a disadvantage: most carriers have their operational or lane inefficiencies built into their base rates. A benchmarked rate base does not account for this, so the carrier must adjust their pricing to specific lanes to account for this shortcoming. Customers who use carriers’ base rates often find they can get better rates through that carrier in certain lanes due to the specific needs of that carrier.

Hanna (Auburn): Over the years, discounts have evolved and become irrationally high. There is increasing discussion that base rates should be restructured and re-indexed to a level that creates a rational discounting process. Do you support this thinking, and how could this be accomplished without creating upheaval in the market?

Manning (CHR): We have come to a tipping point when it comes to the discounting process. While something needs to be done, [changing the system] would be very difficult to accomplish. When you start to evaluate the discounting process, you realize that you are talking about hundreds of carriers’ base rates. We find that as many as 40 to 50 percent of large shippers use old base rates. When you think in those terms—when you look at each of them over the past 20 years—it’s a little mind-numbing.

Burroughs (UPS): I’m not sure there is a strong demand for re-indexing from our customers. In some ways, you already have that with customers who use much older versions of the CzarLite family of base rates. The use of rate-shopping tools somewhat negates the need for re-indexing, because shippers are making their decisions based on the net rate rather than the discount.

Carriers are simply going to price their services based on their costs, so older base rates will have lower discounts. We’ve seen examples where we actually have “add-on” factors to achieve needed revenue levels.

As far as upheaval in the marketplace? Any change will have to evolve. What works for one customer today won’t work for another today, but perhaps in the future it will. Carriers will have to remain flexible in the short term and have the [new] pricing systems evolve over the next few years.

Dove (AAA): At the end of the day, it comes down to price—in dollars and cents. It would be a mistake to re-index the current [pricing] methodology, in my view. Common rate structures like CzarLite would have to be re-indexed, much like carriers’ house tariffs. Over time, carriers would raise rates and discounts, and the entire
process would repeat itself, bringing no ultimate resolution to the issue. This is not the answer.

**Dolan (PBS):** The applied discount is relative. The fact that there is such a wide range of tariffs used in the market is amazing by itself. Based on the state of the LTL industry and volume of users, a mass re-indexing could create so much disruption that it could prove counterproductive.

**Slaton (SMC):** Re-indexing industry base rates could be accomplished with a basic mathematical formula. The data points necessary to develop the formula are available through a variety of industry sources. Concurrent with a re-indexing process, the rate formulas could be adjusted within economic geographies to more closely align regional pricing with regional cost drivers.

Auburn’s Synergic Pricing study showed some interest in re-indexing, but overall less than half of the participants were ready to take this approach, and shippers were the only segment that thought the industry was ready. Without stronger support from all participants, re-indexing success will be problematic. A successful re-indexing initiative will depend on achieving revenue equality, as well as industry education, discipline, and a systematic approach.

**Hanna (Auburn):** Should these rates be re-indexed or should the class-based pricing system be retired and a new system and methodology be put in place?

**Manning (CHR):** In either case, there will be a lot of work involved, and all sides would have to be patient while the process is navigated. However, density-based pricing has its positives, such as paying for the space used and creating a parallel pricing system with other modes, like ocean and air. If shippers, carriers, and 3PLs are willing to go through the process of switching over to a density-based pricing system, it would eliminate the need to talk about re-indexing every 20 years.

**Burroughs (UPS):** While I think there is room for new systems and methodologies, we need to consider what’s best for the customer and the carrier. I believe any system needs to be easier to use, and it must strive to be fair to both parties. With that said, I don’t think any of the current systems will be retired anytime soon.

**Dove (AAA):** The class-based pricing system should be replaced with a system that more accurately calculates general commodities’ impact on space in a trailer, density, and value. Even though the market sets the price, there is a large subsidy across the LTL space as it relates to specific shippers with different classifications that are inaccurate or stretched through class exceptions and FAKs. The system shouldn’t be subjective, like it is now. Measurements and weight are objective calculations. We should be able to agree on those terms.

**Dolan (PBS):** Retiring the current system is much easier said than done. Stability in the current pricing model, which has been around for decades, allows for a more thorough understanding of the cost drivers for shippers; therefore, it has enabled a more effective use of the service. If organized the right way, a new, simplified system based on density and developed through a neutral organization could be promising. The reality of the potential disruption for both shippers and carriers makes this hard to envision, especially given the current fragile marketplace.

**Slaton (SMC):** Anyone who believes that the class-based system can be retired is looking at an alternate reality. Implementing a successful system-wide transition—one that can be used by carriers, shippers, and 3PLs alike—would mean that hundreds of thousands of pricing agreements would be restructured equitably—something that will not occur in the foreseeable future.

However, it is possible for certain segments of traffic—for example, import and export commodities—to move to density- or cube-based pricing that is normalized to reflect how LTL freight is priced in the global supply chain. Again, this pricing transition will need to be evolutionary, not revolutionary, and would improve all parties’ decision-making capabilities for conducting commerce in global markets. The success of this global prototype could influence pricing change in domestic markets.

**Hanna (Auburn):** What impact would you expect on your business if a density-based pricing system was adopted by the LTL industry?

**Manning (CHR):** Most 3PLs today already have systems set up to handle density-based shipments as they’ve adapted their systems to meet the needs of their global customers. As for the industry: there would have to be a clear understanding between the shippers, carriers, and 3PLs on the fairness of a new system. As [a new system] relates to transportation management systems: they might have to be updated to account for the new pricing methodologies.

**Burroughs (UPS):** The most significant impact would be the reduction of “roller coaster” pricing changes—the result of carriers making invalid assumptions. NMFC data from customers is often unreliable. Under a density-based pricing system, revenues would be more closely aligned to costs; carriers would be able to provide customers with pricing that does not need to be corrected several months
later, and customers would be able to more effectively budget their transportation spend and allocate transportation cost to their products.

Dove (AAA): After the pain of the transition eased, it would remove the cross subsidy that exists today. I think many shippers and carriers would benefit from the clarity that it would create. There would also be some freight that is exposed through this process, resulting in a higher rate, and other freight that is perhaps given a lower rate.

As long as the process is accurate and objective, it would be hard to argue that it is unfair. A solid argument or disagreement over pricing can be made today by carriers, shippers, and 3PLs, given the current system. Accuracy and objectivity are not terms I would use to describe our current system.

Dolan (PBS): As an industry, unless a universal model went into effect, it would be very difficult to compare the value proposition between carriers who use a density-based model versus the program in place currently.

Today, we are fortunate to have the CzarLite tariff as a means of equalizing the expense side of the equation between carriers. The industry would still need companies like SMC to enable the ability to standardize to create a means of comparing future pricing proposals. There is more concern about the general “change” issues because of the proliferation of carriers, existing networks, and the sensitive freight environment we find ourselves in today. If carriers did not manage the process of transitioning to a density-based pricing model correctly, it could cause more harm than good and ultimately add costs to shippers through disruption.

Whatever we do as an industry on this topic, we (carriers and shippers) should collaborate to ensure we successfully maintain a sustainable LTL network.

Slaton (SMC): Our core expertise is developing transportation pricing structures including density, and our technology is engineered to deliver that type of information to transportation providers and consumers. We believe technology is a key component on the critical path to LTL pricing evolution. Today the lowest level of technology in the network of carrier, shipper, 3PL, and freight payment determines the level of pricing complexity and accuracy available.

A new generation of pricing technology is under development that provides a way of connecting trading partners through collaborative and private information networks. This new architecture—cloud computing—will support shipment pricing across multiple modes, providing transportation consumers with a variety of options tailored to their service and price parameters. This technology allows all parties to securely share and update their content through an intelligently managed system of access and distribution. We already see this happening through the networks of trading partners, but large-scale systems that provide industry-wide solutions are needed. We see any innovation in LTL pricing—especially innovations that support our customers’ flexibility and long-term success—as an opportunity that will have a positive impact.

Important takeaways
Auburn University researchers and our transportation industry colleagues have gained some unique insights from the research results and discussions around LTL pricing. Perhaps most importantly, we have learned that there are no simple or quick answers or solutions.

While panel experts and our carrier, shipper, and 3PL study participants agreed that an LTL pricing system overhaul is necessary, we have what appears to be an intractable problem: some study participants believed a density- or cube-based system is preferable; others felt the prices reflected in the current system should be re-indexed to enhance the accuracy of information contained in the system; and still others believed no change should be pursued, since they perceived that the current class-based system is so deeply embedded in existing pricing systems that it presents an almost insurmountable obstacle to change.

Who will drive any requisite change process to help the LTL industry more fully integrate with the global supply chain? Study participants indicated motor carriers should drive change—90 percent of carriers believed they should lead the process, while roughly half of the shippers and 3PLs surveyed supported allowing carriers to drive the pricing system change process, and the other half indicated otherwise.

Our study also showed participants agreed on one thing: trust between all parties is a critical requirement for any sustainable pricing change and, ultimately, an industry leader must emerge for pricing change to be methodically and accurately implemented.

I am sure the U.S. LTL industry will face numerous challenges over the coming years—in shaping its pricing strategies and in securing its future in an increasingly multimodal landscape. Though we may not see it clearly yet, we are at a tipping point. As the world continues to evolve and change, we must be prepared to adapt to the new environment.

Trust between all parties is a critical requirement for any sustainable pricing change.