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CASE STUDY – Relieving the Freight Capacity Squeeze

SITUATION:

A leading foodservice manufacturer has enjoyed a high percentage of Customer Pickup (CPU) orders over the years. While CPU's can pose operational challenges at the shipping dock, they also relieve the manufacturer of the burden of booking and paying for transportation.

As freight capacity tightened during 2017, the benefit of CPU orders has only increased for manufacturers. At the same time, foodservice distributors (who historically have pursued CPU opportunities quite aggressively) have begun to feel the pinch from shrinking capacity and rising costs. Our clients' major distributor customers have responded in interesting ways.

One has indicated that they are considering changing from CPUs to Deliveries, which for the manufacturer raises the specter of needing to significantly increase their demand for trucks in a shrinking market. Others have asked the manufacturer to review and consider increasing their freight factors (or delivered prices), essentially asking for a price increase from a supplier!

And another has set up a process to bill back manufacturers for "negative lanes" whenever they are not able to reach a target "CPU Margin" by picking up at a lower cost than taking delivery.

Once again, there's a hot potato being bounced around between manufacturers and distributors, and this time it's called "shrinking capacity and rising costs for transportation."

This is a good place for a couple of explanations:

1. There are two kinds of CPU's:
    a. The kind where a distributor uses his own drivers and equipment to <u>backhaul</u> product from manufacturers (not as impacted by industry capacity issues)
    b. The kind where the distributor <u>arranges his own transportation</u> with a 3rd Party Carrier, the same as a manufacturer would (definitely impacted by capacity issues)

2. It's no secret that distributors like pickups when they can move the product at a lower cost than the manufacturer's freight rate or delivered price. As the distributors' cost goes up, this "CPU Margin" shrinks and distributors are motivated to do things like ask for a price increase.

Our client wisely decided to get out in front of this issue before it became a big problem. They contacted us to determine if we could help them to:

1. Establish pricing and order policies that would maintain customer incentive to pick up or increase Delivered order size
2. Ensure that future freight cost increases were covered by their price structure
3. Investigate opportunities to shift Delivered volume to redistribution

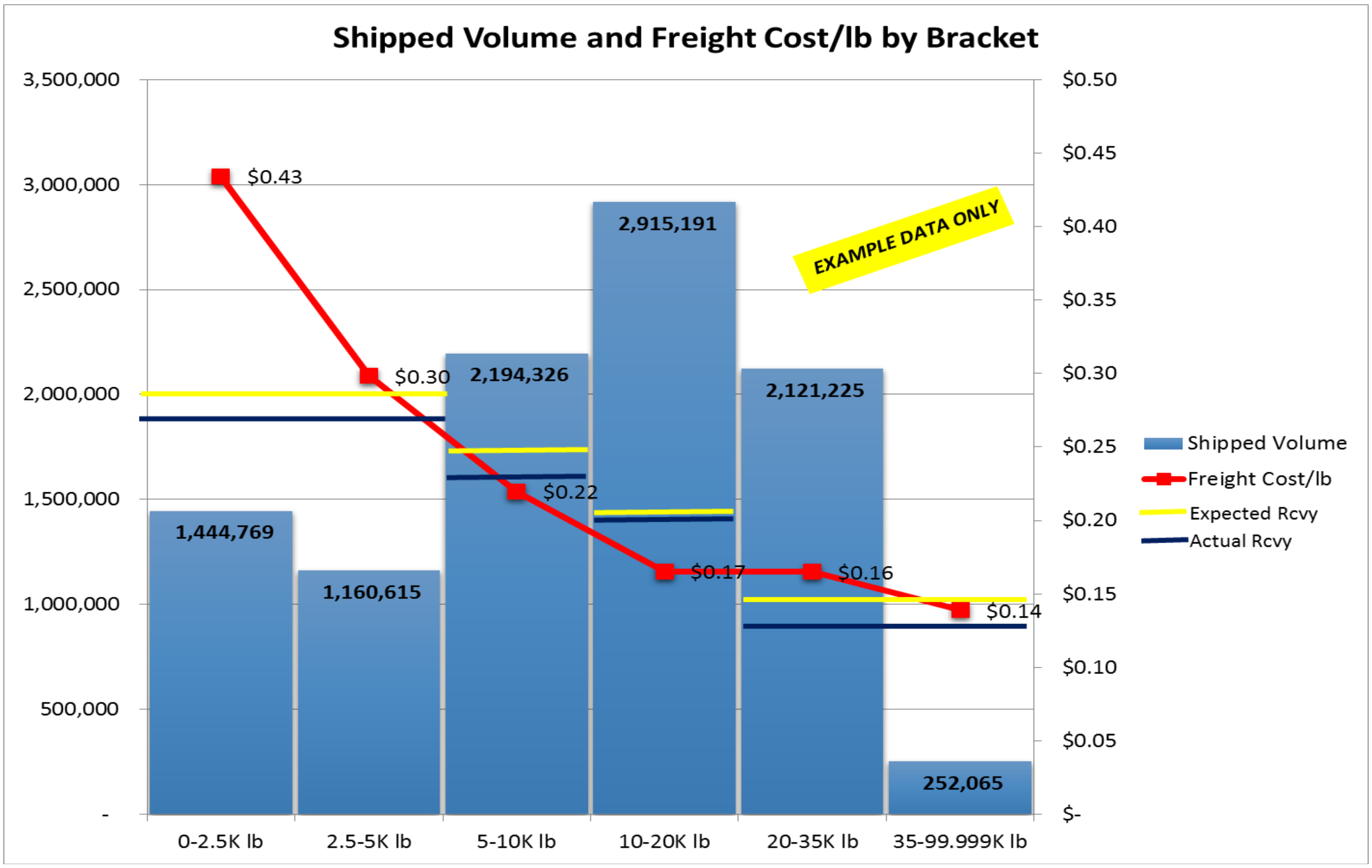
WHAT WE DID:

We agreed that the levers available to us were:

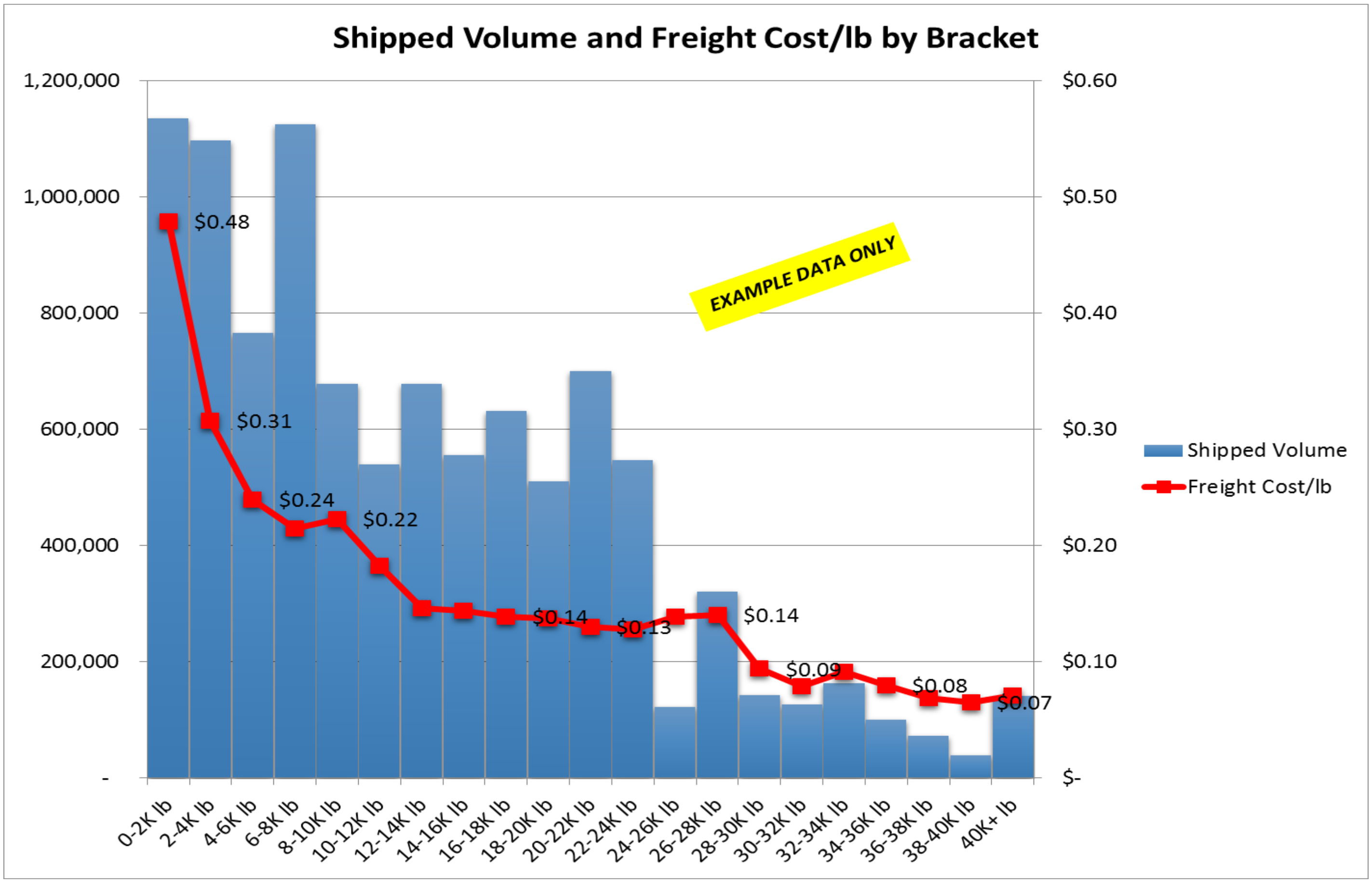
- Definition of Freight Brackets (Lb, Number of Pallets, etc.)
- Number of Brackets
- Price Premiums across Brackets
- Zone vs. National Pricing
- Order Policies and Enforcement, especially Order Minimums

We began by mapping the geographic locations of key CPU customers, and calculating actual freight costs and delivered freight rates for each market. This provided insight into customers' inbound freight costs, and which markets represented risk of customers switching to Deliveries.

Next we analyzed 12 months of shipment and CPU data by order, and mapped out Volume, Freight Cost, Expected Freight Recovery, and Actual Freight Recovery by Weight Bracket.



In addition to existing Freight Brackets, we mapped the data by “2000 lb Increments” in order to look for natural breaks in volume and cost by bracket.



Based on the results, we were able to model many different combinations of Number of Brackets, Bracket Definitions, and Price Premiums across Brackets.

Finally, because this manufacturer has an existing Redistribution Program, we were able to create a “Redi vs. Direct P&L” by order size to clearly indicate the financial impact of moving volume from Direct to Redistribution service.

RESULTS:

Based on the results of our analysis, we worked with the manufacturer to establish a new price structure and policies which:

- Added a new “Maximum TL Bracket” with incentives for customers to max out their TL orders
- Adjusted Freight Premiums across Brackets to:
    - Reflect future freight costs
    - Ensure “CPU Margin” for key Distributors
    - Provide sufficient Gross Margin for the Redistributor
- Reduced the number of “Less Than Minimum” orders and shifted them to Redistribution service

Initial response from customers has been positive, and Sales is in the process of rolling out the new price structure nationwide. For further information, contact Dave DeWalt at 239/395-2787 or dave@franklin-foodservice.com