The shortage of transportation capacity is driving new behaviors!

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How Will You Ease the Squeeze?

It’s no secret that the balance between transportation capacity and demand is at an historic low. Every week, we get newsletters telling us how bad it is, and how it’s likely to get worse before it gets better.

There are many well-documented forces which contribute to the problem, including:

- Strong overall economy
- Hurricane recovery pulling trucks into Florida and Texas
- Stricter “Hours of Service” (HOS) rules limiting capacity
- Electronic Logging Device (ELD) requirements eliminating “fudging” of driver logs

In short, transportation is a hot potato being batted around between suppliers and customers!

- Shortage of qualified drivers due to:
    - tighter security requirements
    - stricter substance abuse testing
    - competition for labor from strong construction industry (see Hurricane Recovery above)
    - aging pool of drivers not being replaced by younger drivers

Now the obvious result is an increase in rates, and in fact some reports say January transportation rates were up 30-35% vs. last year! And the forecast for the rest of 2018 is for continued increases.

While there is hope that conditions and costs will stabilize, the truth is no one knows what's in store. For an excellent summary of the situation, see the paper from Blimling and Associates entitled "Reefer Madness" (baby boomers like me should find that title funny….)

But there's more going on here than higher freight costs. The dynamics that impact distributor decisions regarding whether to submit orders for pick up (CPU) or take delivery have been knocked off-kilter.

Before we go further, I should clarify that there are two kinds of CPUs:

1. The distributor uses his own equipment to backhaul product from a supplier (ideally after making customer deliveries)
2. The distributor books his own third party carrier and pays the freight himself

While there are considerations such as the location of the supplier's plant or warehouse and the ability to pick up from multiple suppliers in the same geography, the overriding reason for CPUs is to save money. In the "own equipment" scenario the distributors probably assign an internal cost of transportation which is lower than the manufacturer's delivery charge. And distributors use the "third party" scenario when it allows them to pay less to the carrier than they would to the supplier on a delivered order.

Over the past few years, I've noted that distributors became quite aggressive about pushing for CPUs. I'm told that some distributors book the difference between a manufacturer's quoted freight rate and their landed cost of a CPU as a profit center. Other motivations include separating and understanding product cost vs. freight cost, and maximizing return on their transportation assets.

But some of the new behaviors our clients have witnessed as a result of tight capacity include:

- Distributors who have historically picked up attempting to move to delivery
- Distributors asking manufacturers to reconsider (raise) their delivered freight rates to retain the differential that drives the CPU decision
- Distributors beginning to bill back manufacturers for lost income on "negative loads," including a list of lanes where the distributor can no longer "earn" the difference between their cost and the manufacturer's delivered price(!)
- Manufacturers attempting to "lock" their distributor customers into either CPU or Delivery based on their history
- Manufacturers re-thinking the role of redistribution and the potential to offload a large chunk of their shipping activity

While higher freight costs are the biggest concern, there is also fear of the need to find and book carriers on the part of both manufacturers and distributors. Manufacturers who already struggle to book loads don't like the prospect of all of their CPUs turning into deliveries. Likewise, distributors who use third party carriers for CPUs are losing their incentive as costs rise and approach the cost of taking delivery.

In short, transportation is a hot potato being batted around between suppliers and customers!

Savvy manufacturers are getting in front of the situation by reviewing their price structure, weight brackets and freight rates. They're considering whether an "FOB plus Freight" or "Bracketed Delivered" price structure is best, and whether National Pricing or Zone Pricing makes more sense. And they're offering programs and enforcing policies which will incent more CPU's and more large orders, while shifting numerous small orders to redistribution.

If you're not trying to get in front of the freight capacity crisis, you're likely to be left behind.

So what are you doing to ease the squeeze?

Click here **if you'd like to start a conversation about steps you can take to ease the pressure.**

And watch for the next issue of "Stirring the Pot," which will feature a Case Study from a recent manufacturer who has taken a proactive approach.