The New Tenets of Transportation

23rd Annual Trends and Issues in Transportation and Logistics

September 2014

NOT ALL IS LOST

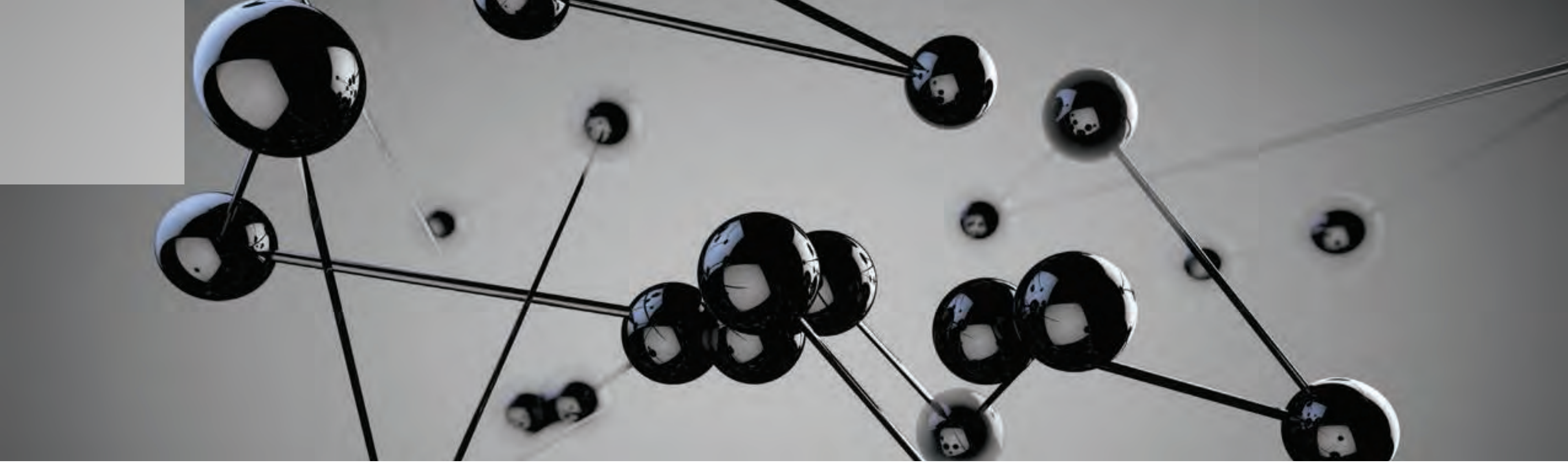
Welcome to the new business reality: an environment striving to balance cost-to-serve, changing customer requirements and demand uncertainty. An environment of changing regulations, labor shortages and uncertain fuel costs. The global recession signaled changes to the operating parameters of the game that most of us didn't fully understand. It has given temporary advantages to carriers, much like the shippers had in earlier times. Yet, like tug of war, the game results in one winner and one loser.

But why does there have to be one winner at the expense of the loser? Could it be that shippers and carriers are playing the wrong game? After all, there are opportunities for both shippers and carriers if they follow a path that will lead to mutual benefits.

The results of the 23rd Annual Trends and Issues in Transportation and Logistics suggest that the current business environment has created a struggle between shippers and carriers that is changing the nature of their relationship. Carriers and shippers stand at opposite poles, with carriers driven by a need to maximize profitability and shippers focused on reducing costs. This lack of alignment has created a tug of war that has resulted in a loss of focus on the bigger prize — winning at the game of business. Winning this game requires collaboration between carriers and shippers to deliver best value in terms of service, cost and innovation for the ultimate customer.

Our hope is that our study will provide useful information regarding current trends and assist you in better managing your organization and working with your partners to collaborate in this dynamic arena.

None of this would be possible without the support of our respondents and partners. We are thankful for your continued participation.



THE NEW TENETS OF TRANSPORTATION

1| PICK YOUR PARTNERS CAREFULLY

It has been said that a great team makes the difference between success and failure. The annual study results indicate that, while transportation service offerings tend to be standardized across the various carriers, the services provided vary considerably among the providers.

2| PLAY THE SAME GAME

Tightening transportation capacity, propelled by a growing truck driver shortage, is beginning to significantly impact shippers as transportation cost as a percent of sales is rapidly increasing. Shippers and carriers have diametrically opposed goals — shippers seek to reduce costs and carriers want to maximize profit. Is this the game that carriers and shippers should be playing? Or, should they change the rules of the game and work together to solve problems that impact both of them?

3| COLLABORATION IS A GAME WINNING STRATEGY

The complex problems facing today's global supply chains require the collective efforts of shippers and carriers to constructively explore ideas for innovative solutions. Individual efforts are no longer sufficient, as they limit the potential to grow. Collaboration is needed to tackle the complex problems presented by the current business environment, ultimately enabling both parties to achieve their goals.

4| MIND AND MINE THE GAPS BETWEEN CURRENT AND DESIRED STATE FOR THE WINNING EDGE

As a collaborative team, it is important to identify the gaps between current and desired future practice. This analysis provides the basis for mutually deciding the priority of actions to close the gap. Shippers and carriers that master the gaps will be able to leverage their knowledge and expertise, even when they have conflicting goals.

5| MAINTAIN YOUR POSITION

Transportation decision making is shifting to include more involvement by procurement. As procurement gets more involved in everything from preparation and solicitation of requests for quotes (RFQs) to carrier performance and evaluation, there is concern that this area does not fully understand the complexities of this service. Without relinquishing their key role in this process, transportation decision makers are evolving to a more jointly managed process.

1| PICK YOUR PARTNERS CAREFULLY

Carriers and shippers agree on two fundamental principles:

- **Strategic or core carriers help their customers achieve business goals and objectives through services provided**
- **Strategic or core carriers add value through the transportation services they provide**

Our study suggests that selecting a strategic or core carrier is one of the most important decisions a shipper can make. When interviewing top management at the top truckload (TL) and less-than-truckload (LTL) carriers, there seemed to be a perception that service levels within a competitive set was essentially the same. In other words, it was not significantly different. However, shippers had a different story to tell. The data from this group indicate that, for several service attributes, the difference between the top (first) and third ranked carriers is quite large.

CREATING A COMPETITIVE ADVANTAGE THROUGH SERVICE DIFFERENTIATION – TL CARRIERS

Attribute	Top TL Carriers	3rd Ranked Carrier	Difference between 1 and 3
Transit time reliability	1.84	2.35	27.7%
Total door-to-door transit time reliability	1.89	2.31	22.2%
Equipment availability/commitment to allocate equipment	1.87	2.53	35.3%
Flexibility (e.g. willingness to negotiate rate or service changes)	2.13	2.5	17.4%
Bundled service (including multimodal capability)	2.24	2.72	21.4%
Freight loss and damage	1.56	2.06	32.1%
Talent of key personnel	1.84	2.52	37%
Technology capability	2.05	2.31	12.7%
Value-added services offered	2.18	2.68	22.9%
Ease of doing business (e.g. efficiency in claims processing)	1.84	2.39	29.9%
Commitment to sustainability	2.23	2.47	10.8%
Door-to-door competitive transportation rates or costs	2.08	2.73	31.3%

Scale: 1 = very good; 5 = very poor

"RECRUITING AND RETAINING TALENT IN THE DRIVER'S SEAT AND IN FRONT-LINE MANAGEMENT IS A KEY TO OUR FUTURE SUCCESS. NEVER HAS THIS CHALLENGE BEEN SO GREAT."

Gregory Lehmkuhl, President, Con-way Freight

Transportation services represent a set of performance characteristics purchased at a given price by a shipper. Our data suggests that significant service level gaps between the top and third-ranked LTL carriers. The difference in service levels is larger than for TL carriers. Transit time reliability and the total door-to-door transit time reliability scores reveal considerable opportunity for LTL carriers to create a competitive advantage through service differentiation. Equipment availability and the carrier's commitment to allocated equipment appear to be other areas that are major factors in carrier selection.

CREATING A COMPETITIVE ADVANTAGE THROUGH SERVICE DIFFERENTIATION — LTL CARRIERS

Attribute	Top TL Carriers	3rd Ranked Carrier	Difference between 1 and 3
Transit time reliability	1.68	2.39	42.3%
Total door-to-door transit time reliability	1.70	2.54	49.4%
Equipment availability/commitment to allocate equipment	1.59	2.34	47.2%
Flexibility (e.g. willingness to negotiate rate or service changes)	2.16	2.49	15.3%
Bundled service (including multimodal capability)	2.45	2.55	4.1%
Freight loss and damage	2.04	2.69	31.9%
Talent of key personnel	1.89	2.46	30.2%
Technology capability	1.91	2.36	23.6%
Value-added services offered	1.98	2.36	19.2%
Ease of doing business (e.g. efficiency in claims processing)	1.8	2.5	38.9%
Commitment to sustainability	2.13	2.58	21.1%
Door-to-door competitive transportation rates or costs	1.68	2.29	36.3%

Scale: 1 = very good; 5 = very poor

2| PLAY THE SAME GAME

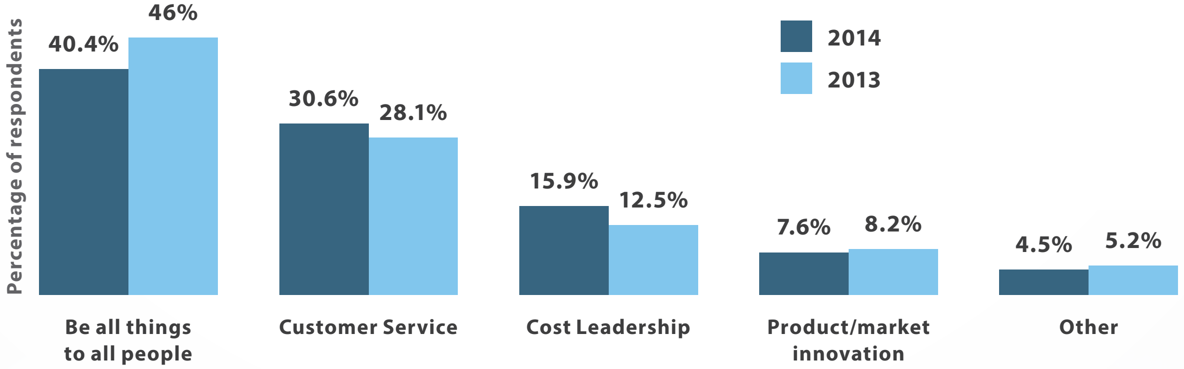
Strategy defines why companies exist. When it is done right, it becomes a key element in why companies succeed.[1]

Companies no longer have the luxury of just focusing on being a cost leader or concentrating on customer service. Instead they must find ways to balance efficiency and effectiveness such that the result is competitive differentiation. While the mix strategy is still the primary framework for tactics and operations for most companies, there is a shift away from this position to more emphasis on service and cost leadership.

This shift is particularly interesting as prior to 2008, customer service was the dominant strategy.

A successful strategy requires a company to "do things right" and to also "do the right things." At the operations level it often takes the form of trade-offs. Unfortunately, companies that try to be all things to all customers risk confusion as employees attempt to make day-to-day decisions without a clear structure for achieving the optimal balance between efficiency and effectiveness.

A CLEAR STRATEGIC DIRECTION



"COMPANIES CANNOT BE A DEMAND-DRIVEN SUPPLY CHAIN LEADER WITHOUT THE ACTIVE ENGAGEMENT OF THEIR STRATEGIC TRANSPORTATION CARRIERS. THIS NECESSITATES THE DEVELOPMENT OF A JOINT STRATEGY TO ACHIEVE THE DESIRED END STATE."

Joel Clum, President, CarrierDirect

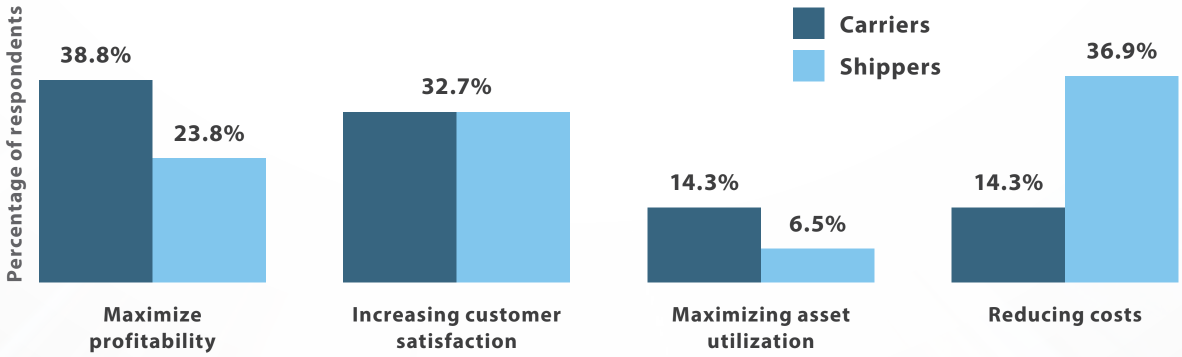
[1] Cynthia Montgomery, The Strategist: Be the Leader Your Business Needs, Harvard Business School, May 2012.

When it comes to strategy, both shippers and carriers seem to be playing the same game. That is, both are using these same basic strategies. However, the similarities end there. To borrow a quote from the 1967 film Cool Hand Luke: "What we have here is a failure to communicate."

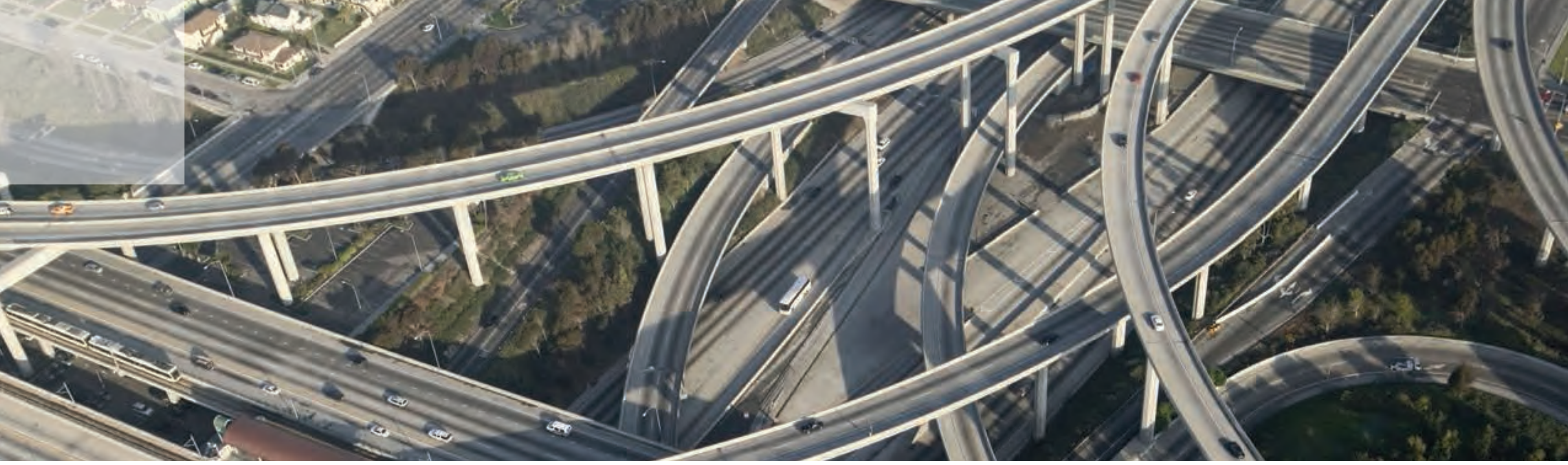
This quote characterizes the difference that exists between shippers and carriers in their strategic directions. Several factors are driving transportation costs up, such as driver shortages, loss of productivity due to changes to the Hours of Service Rule and the process of converting to electronic on-board recorders, which must be completed by January 2016.

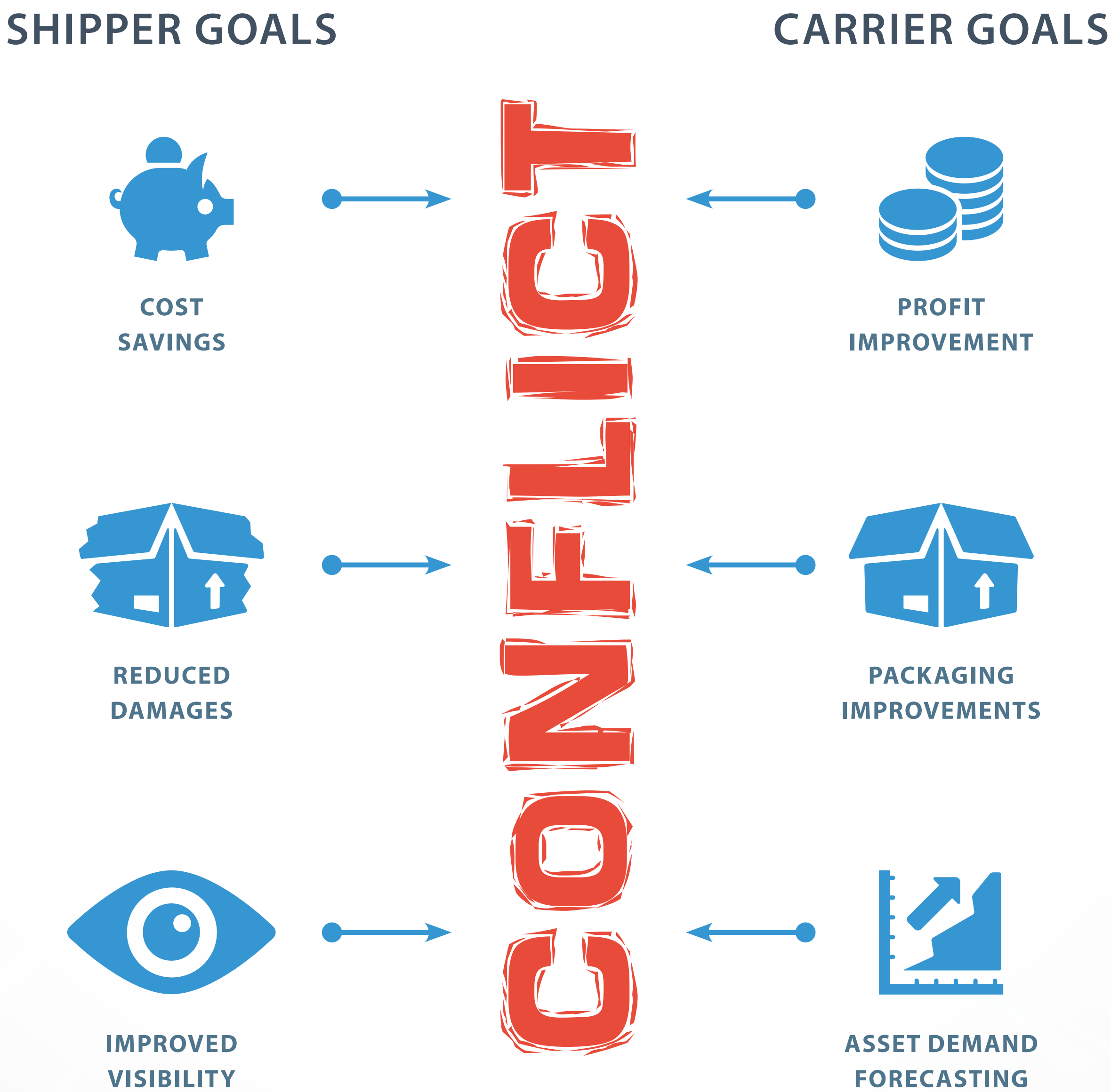
It has been estimated that these three factors alone will contribute to a 17 percent cost increase in transportation.[2] It is imperative that shippers and carriers align their goals and objectives in order to maximize the results of their collective efforts. However, the analysis indicates that these two groups have diametrically opposite goals. Shippers are focused on reducing costs in a less-than-robust global business environment, while carriers see a market opportunity to maximize profitability. Just like in the film, what we have is a failure of strategic partners to communicate with each other regarding this key element that sets the stage for tactical and operational decisions. The conflict extends to more than just cost savings and profit improvement. It involves matters like reducing damage, which will generally necessitate improvements in packaging. Shippers would also like to have improved shipment visibility, while carriers want more information about future capacity demand.

"WHAT WE HAVE HERE IS A FAILURE TO COMMUNICATE"



[2] Dan Gilmore, "The Coming US Logistics Cost Crack-Up?" Supply Chain Digest, September 5, 2014.





Source: Con-way Freight, Inc.

3| COLLABORATION IS A GAME WINNING STRATEGY

Shippers face an interesting market. Carriers are experiencing higher costs, tighter capacity, shifting demand and reduced lead times. Selecting the right carrier to partner with is just the beginning of developing a strategic partnership that grows shared values. It is through collaboration that shippers and carriers move closer to achieving mutual benefits even when they have opposite goals. This is partially attributed to the fact that collaboration has the potential to improve performance by reducing the uncertainty that drives inefficiencies in both groups.

The majority of transportation expenditures (29.1%) are for truckload freight moves. 21.1% of the spend is allocated to less-than-truckload. At 8.8% of the transportation budget, dedicated fleets are an important modal option.

How do shippers and carriers get to this desired point? Understanding what shippers want when selecting a strategic or core carrier is a good starting point. Our data suggest that carriers need to understand their mission to reduce costs. This is reflected in 'cost of service' being the top ranked factor when selecting a strategic carrier. While cost is important, two attributes are almost equally essential — capacity commitments and the potential for a long-term relationship. Service is also a critical part of carrier selection; performance factors were ranked by shippers as having very high importance when choosing a transportation service provider.

SHIPPERS' PERSPECTIVE: WHAT MATTERS THE MOST WHEN SELECTING A STRATEGIC CARRIER

Very High Importance
Cost of service
Capacity commitments
Potential for long term relationship
Performance factors (e.g. service levels, safety record)
High Importance
Ability to respond to changes
Industry trends (shortages/overcapacity)
Ease of doing business (e.g. administrative efficiency in claims processing)
Strategic importance of the services to the overall business
Carrier's reputation

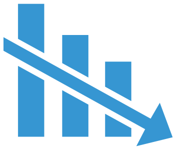
“ONLY THROUGH STRATEGIC ALIGNMENT AND JOINT PROBLEM SOLVING CAN SHIPPERS, CUSTOMERS AND CARRIERS REBUILD CAPABILITY TO DELIVER PRODUCT ON-TIME. CURRENT BEHAVIOR AND CONFLICTING OBJECTIVES WILL NOT SOLVE THE INDUSTRY PROBLEMS RELATED TO EMERGING TRANSPORTATION SUPPLY CONSTRAINTS.”

Steve Harmon, VP of Transportation, Kimberly-Clark Corporation

Three top priorities emerged from the annual study that should serve as the guiding principles for carriers seeking to build a collaborative relationship with shippers. These priorities are reinforced throughout various parts of the study, suggesting a well-defined framework for developing shared values.

It is worth noting that not every carrier should be a strategic partner. In the same manner, not every shipper should be a carrier’s strategic partner. The key is to determine if the benefits from the collaborative relationship will result in strategic and operational advantages that would not be possible without the alliance.

TOP SHIPPER PRIORITIES



CONTINUOUSLY STRIVING TO REDUCE THE COST OF TRANSPORTATION

THOROUGHLY UNDERSTANDING CUSTOMER NEEDS

SEEK TO CONTINUOUSLY REFINE AND IMPROVE TRANSPORTATION SERVICES

INTENSITY OF INVOLVEMENT IN THE RELATIONSHIP: DO YOU SHARE THE SAME PERSPECTIVE WITH YOUR CARRIER OR SHIPPER?

4| MIND AND MINE THE GAP BETWEEN CURRENT AND DESIRED STATE FOR THE WINNING EDGE

To “mind” means to pay attention or concentrate on something. For shippers, one of the primary things they “mind” is the service they receive for the money they spend. Our study finds mixed performance outcomes for 2014 as compared to 2013. The transportation performance scorecard is a compilation of five service elements: on-time delivery, over/short/damage, correct invoice, equipment availability and turndown ratio. The scores for all five elements are equally weighted to calculate an overall score for each mode.

All modes showed substantial declines in damaged shipments. On-time delivery for TL and intermodal declined, with TL lagging the most in this important service element. TL, LTL and intermodal showed meaningful declines in equipment availability. In the case of TL, this service challenge was also reflected in the turndown ratio, which increased substantially.

TRANSPORTATION PERFORMANCE SCORECARD

High Importance	Very High Importance
Ability to respond to changes	Cost of service
Industry trends (shortages/overcapacity)	Capacity commitments
Ease of doing business (e.g. administrative efficiency in claims processing)	Potential for long term relationship
Strategic importance of the services to the overall business	Performance factors (e.g. service levels, safety record)
Carrier’s reputation	Carrier’s reputation

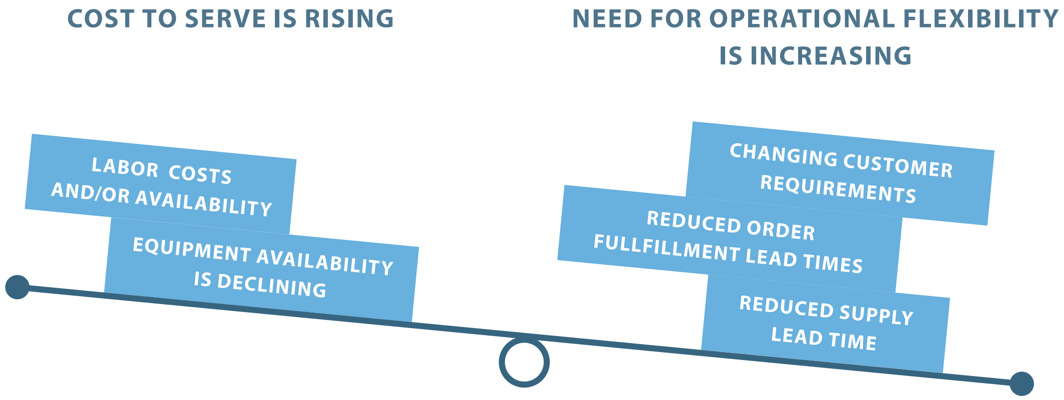
Service Attribute	Best Customer	Average Customer
On-time delivery	96.3%	92.7%
Over / short / damage	1.0%	1.7%
Correct invoice	97.8%	96.1%
Shipments with a customer complaint	1.1%	1.8%
Backorders	2.3%	3.5%

WHO YOU ARE DOES MATTER

The best customers did receive better service than average customers. This is good news, as delivering “one size fits all service” is inefficient and reduces the resources that could be utilized more effectively.

Our study results show that the primary thing on the mind of shippers is the increasing cost of serving customers. Increasing transportation costs, driven by a host of factors, have created a tug-of-war between shippers and carriers, as each side seeks to achieve their goals. To make the situation worse, constantly changing customer requirements, coupled with increasing demand uncertainty, has created an environment of continuously shifting rules.

A DIFFICULT BALANCING ACT



To address these challenging conditions, shippers are working on increasing their operational flexibility. The data show that companies have identified several key initiatives as being the most important in assisting them to achieve greater flexibility. These are: reducing order fulfillment lead times and supply lead times, integrating internal processes, and increasing collaboration with key customers and suppliers.

How do these priorities line up with completed initiatives? In many ways, they are quite different. The results show deployment of multiple modes of transportation is the most frequently completed action by companies to increase their agility and responsiveness. To date, 45.9 percent of companies have finished implementing this initiative.

MOST FREQUENTLY COMPLETED FLEXIBILITY INITIATIVES

- **Utilization of multiple transportation modes**
- **Alignment of labor force skills to better meet changing demand requirements**
- **Shared capacity forecasts and increased collaboration with key customers**

Many of the more difficult initiatives — and some of the most important ones — to improve operational flexibility are underway, including the integration of internal processes and increased collaboration with key suppliers.

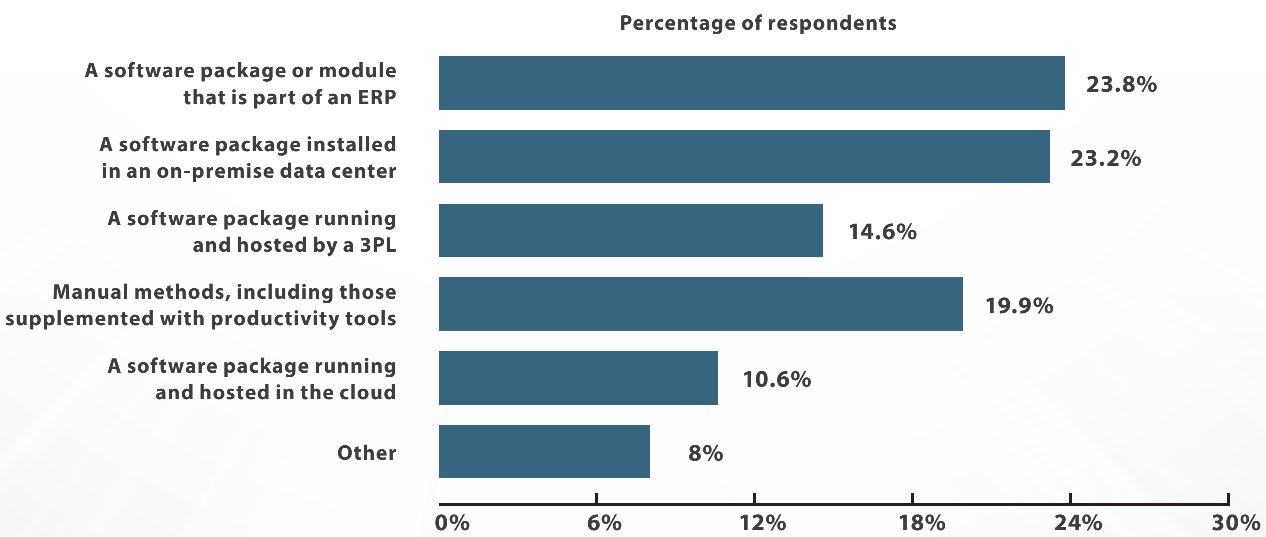
5| MAINTAIN YOUR POSITION

The tools and techniques that are used to manage complex transportation activities can either facilitate or impede efficiency and effectiveness goals. To maintain a competitive position, shippers and carriers must utilize the optimal tool for their operating environment. The challenge is that the ways in which we manage transportation activities are constantly changing due to technology. The positive aspect of this is that technology has enabled companies to plan operations that maximize their efficiency while also increasing their effectiveness.

Data from the study indicate that companies prefer to own their transportation management software (TMS). Some 47 percent of all respondents either choose a package that is part of their ERP or they purchase a TMS that is installed on their system. The 2014 study marked a change in how we assess the tools and techniques used to manage transportation. For this reason, some of the results are not directly comparable to previous years. One category that can be compared is the use of 3PL software to manage transportation. In 2014, this approach was used by 14.6 percent of respondents as compared to 8.7 percent in 2013. This increase reflects the fact that some companies, the lack of internal expertise and available resources make this the most viable option.

A variety of technology options are available for every size company. Transportation technology specifically has enabled companies to become more demand driven and to develop innovative practices such as collaborative supply chains. The use of technology to manage transportation activities has set the threshold for maintaining a key position in the game.

MANAGING DOMESTIC TRANSPORTATION



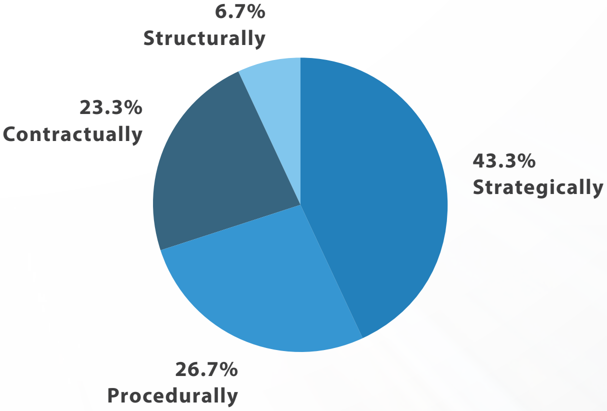
In the past, transportation and distribution functions either reported to the same person who made the needed trade-off decisions, or the respective functions met on a regular basis to discuss strategic decisions for both areas. Now, the nature of the game is changing, as procurement departments are becoming more engaged in the selection, negotiation and evaluation of carriers. Currently these functional activities are primarily managed by transportation and logistics managers. The emerging model of the future is a joint one between procurement and transportation.

	Preparation and solicitation of RFQs	Carrier Negotiations	Operational Planning	Carrier Performance Evaluation
Purchasing/Procurement	9.8%	7.4%	3.7%	3.8%
Transportation/Logistics	63.4%	77.8%	79.0%	80.8%
Jointly by procurement and transportation	25.6%	11.1%	16.15%	14.1%
Other	1.2%	3.7%	1.2%	1.3%

Maintaining your position is becoming more difficult, as the actual the way transportation has been procured in the past is not how it will be managed going forward. Our data shows that firms are taking a more strategic focus as it relates to transportation. If carriers are to maintain their position, they will need to better understand how to better interact with their shippers. Internally, shippers will need to align expectations and communicate these changes to their core carriers.

HOW HAS PROCUREMENT OF TRANSPORTATION CHANGED AT YOUR FIRM?

- **Procedurally, with a different purchasing process now than in the past**
- **Contractually, with changes in areas such as the length of contract or specificity of service quality**
- **Strategically, with a different focus now than in the past such as a shift from cost to quality of service, or vice versa**



THE NEW TENETS OF TRANSPORTATION: REWRITING THE RULES OF THE GAME

The results of the 23rd Annual Trends and Issues in Transportation and Logistics suggest that the current business environment has created a struggle between shippers and carriers that is changing the nature of their relationship. Driven by a need to maximize profitability, carriers are at a polar opposite with shippers who are focused on reducing costs. This lack of alignment has created a tug of war that has resulted in a loss of focus on the bigger prize – winning at the game of business. Winning this game requires a collaborative team of carriers and shippers that are aligned to deliver best value in terms of service, cost and innovation for the ultimate customer.

We posit that five new tenets should be used to pave the road forward. The winners in the current business environment will be those companies that pull together in order to achieve their opposing objectives.

Supply chains are weakened when individual members attempt to gain an advantage over the other, losing sight of the other competing supply chains on the field. While a shipper or carrier might win in the short term, they neglect to take into account the future consequences of "tribalism" actions. In today's global marketplace, it is truly supply chain competing against supply chain. As a member of a supply chain, it is critical that the members pull together. The existing atmosphere between carriers and shippers is untenable in the long term if both desire to succeed.

The results of the annual study present a compelling argument for reforming the current relationship between carriers and shippers.

WE SUGGEST AN OPEN AND HONEST DIALOGUE WITH YOUR STRATEGIC PARTNERS AROUND THESE QUESTIONS:

- **Is the current course actually working?**
- **Is it taking cost out of the supply chain?**
- **Is it increasing service levels to customers?**

If the answer to any of these questions is no, the conversation needs to shift to how to make that answer a resounding "yes". The opportunity for growth exists if shippers and carriers find a path forward that results in mutually beneficial results.

NOT ALL IS LOST. MUCH IS LEFT TO BE GAINED.

PERHAPS 2015 WILL BE THE START OF MEETING AND EXCEEDING EVERYONE'S EXPECTATIONS.

AUTHORS

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Joel Clum is president of CarrierDirect, a transport and logistics management consultancy. The company works with asset and non-asset companies in the freight industry to design strategies and offer services to support their growth and capability development. The CarrierDirect team consists of industry experts across numerous disciplines to advise clients on a range of opportunities and challenges.

Some 766 domestic and global logistics, transportation, and supply chain professionals participated in this year's study, offering insights on trends and issues relevant to today's busy managers. Participants accounted for an estimated $19.7 billion in domestic transportation expenditures and over $11.4 billion in international transportation. Large companies with annual revenue of more than $3 billion represented 17.3% of the study participants. Medium sized firms, with between $500 million and $3 billion in annual revenue were 29.4% of respondents. The majority of respondents (53.3%) were smaller firms with reported annual revenue less than $500 million.

Respondent companies represent a broad and diverse set of fifteen industry sectors ranging from pharmaceuticals to food. Since the beginning of the study, the core group of participants has been in the manufacturing sector—this year they made up 32.8% of the total. Consumer products' companies represent the largest sub-sector of that group at 11.5%. Over the past several years we have strived to increase the participation of transportation providers in the study in order to more fully understand this perspective. This year that sector comprised 22.6% of all participants which enabled us to do some comparative group analysis.

Icons made by Freepik.

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