2012 PARCEL EXPRESS ROUNDTABLE

Are regional entrants storming the gates?

Our distinguished panel tells shippers to expect to pay more for parcel services, be on the lookout for competition among existing carriers, and keep your eyes open for new regional entrants.

BY **JEFF BERMAN,** GROUP NEWS EDITOR

Despite the stop and start nature of the economy, parcel market activity—on both the express and ground side—is actually flourishing. While volume growth has been slight, parcel carriers are taking this opportunity to adjust and invest in service offerings to best meet shipper needs.

At the same time, the duopoly of industry bellwethers UPS and FedEx continues to dominate the market to a large degree. However, this year's panel of parcel market analysts tells us that there are opportunities for regional entities and niche providers to make inroads—and offer new services that could eventually put pricing pressure on the "big two."

Joining us to put this dynamic market into perspective are Jerry Hempstead, president of Hempstead Consulting; Doug Kahl, principal of Integrity Logistics Consulting Group and executive consultant at TranzAct Technologies; Rob Martinez, president and CEO of Shipware LLC; and David Ross, transportation and logistics director at Stifel Nicolaus.

Our distinguished panel offers shippers their views on parcel market trends, pricing, and the state of the United States Postal Service in this wide-ranging discussion. Heading into 2012, they're telling shippers to expect to pay more for parcel services, be on the lookout for competition among existing carriers, and keep your eyes open for potential new regional entrants.

Logistics Management (LM)*: Since the beginning of 2011, how would you describe the parcel marketplace?*

David Ross: We've seen rational competition with rising prices, but steady service levels. In fact, I think things are now better than a year ago, as UPS, FedEx, the USPS, and the regional carriers continue to invest in services and technology.

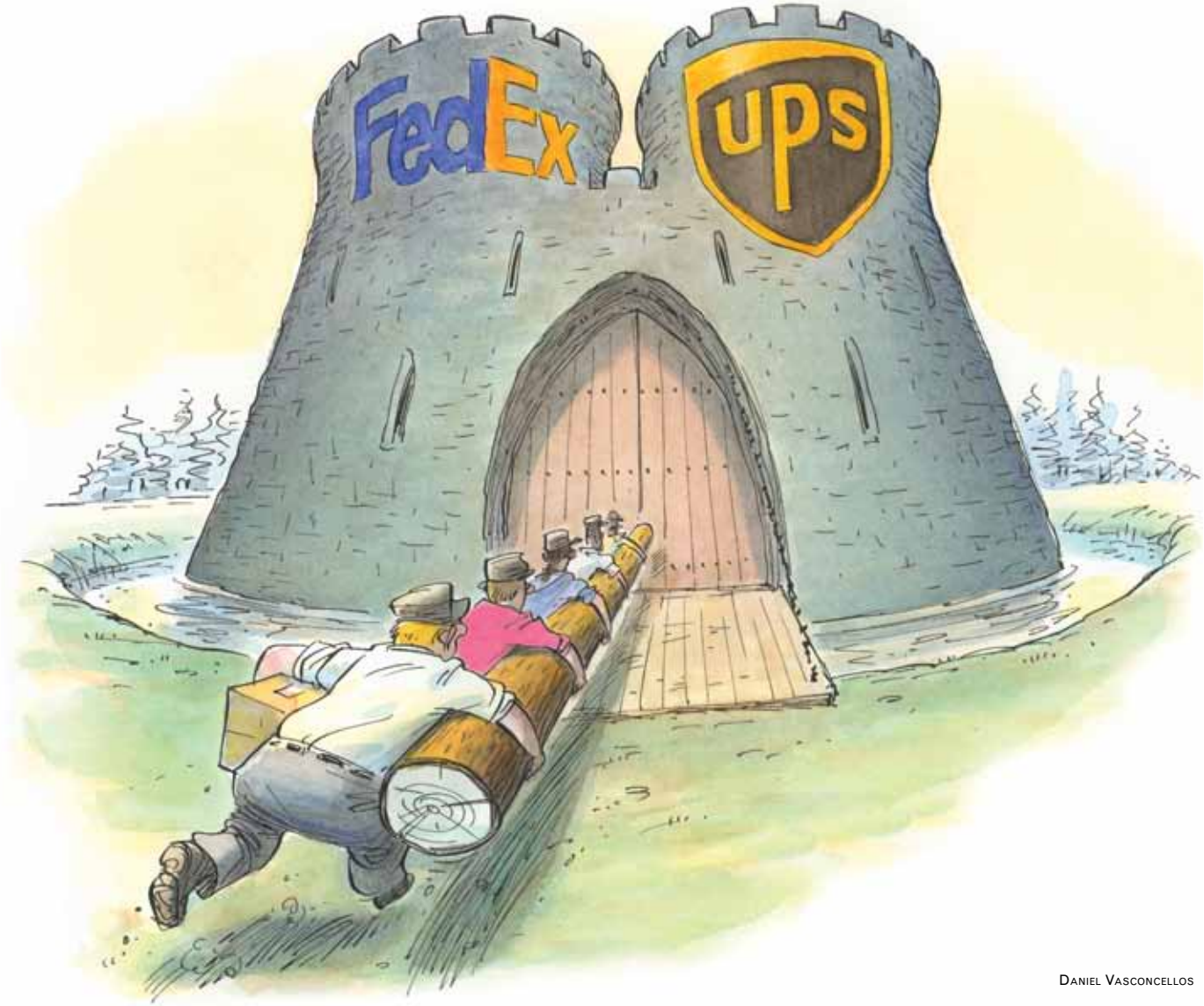
Jerry Hempstead: This year has been at all time high for service levels for all the major players. If anything, FedEx ground has been pushing the envelope and rapidly expanding its footprint and tightening its service commitments. UPS has been forced to reexamine its service in order to be competitive on the ground; and the USPS has vastly improved its package tracking that will further improve next year with some enhancements they're adding.

Doug Kahl: I agree with Jerry. If you consider the two primary providers, FedEx and UPS, then the condition would be described as "good"—especially with the recent announcements of profitability and predictions of record holiday volume. But if you consider the dire financial condition of the USPS, it's not as rosy. We see the regional carriers gaining traction and other options from consolidators that could lead to some optimism for having additional service choices.

Rob Martinez: I would say that it depends on your perspective. If you're UPS or FedEx things are better now. Take a look at recent quarterly earnings report for UPS. While volumes have been flat, revenues are up 8 percent. The result, of course, is a lack of U.S. competition and aggressive yield management. If you're a shipper, things are certainly not better off than a year ago since pricing is tighter today and fuel surcharges are higher.

LM: *How would you describe the current rate and pricing environment for parcel shippers?*

Martinez: Pricing is as rational—tight—as I've ever seen it. Both big carriers have been very forthcoming that the past two years have been all about margin improvement. Now that we're down to only two major express parcel delivery companies in the U.S., each January we're consistently seeing the



Daniel Vasconcellos

most severe rate increases in my 22 years in the industry. Not only have published list rates gone up significantly, so too have accessorial and dimensional charges.

We're seeing carriers make subtle changes to contract language resulting in enormous increases. For example, in 2011 UPS developed a new set of published rates for the first time called "standard." Standard rates are 6 percent to 30 percent higher than historical "daily" rates for air services, and it's very likely that many shippers will see their UPS contracts go from daily to standard rates.

Hempstead: The marketplace is at the mercy of a pricing duopoly. UPS controls ground pricing, and FedEx controls where air pricing goes. Each looks to the other to announce the "good news" for the following year. Neither is interested in trying to enter into a price war to gain the other carriers accounts with lower prices and logically lower yields.

Kahl: Actually, every year you read about how the rate increases are historic, unprecedented, excessive, and so on. When I look at the analysis, I see a consistent, measured action being taken. You have to do a deep dive into the rates by service level, zone, and weight to understand how much or how little the pricing will change on your book of business.

LM: ***Where do you see rates going in 2012 and why?***

Kahl: Any way you cut it, rates are going up. Shipper's need to compare their service level, zone, and weight distribution pattern to the actual new rates to identify the real impact the 2012 increase will have on their cost.

Hempstead: Costs to send a parcel increased significantly for shippers in 2011. There's just no way of getting around it in 2012. There were two significant changes. First, the minimum charge went up far more for ground than the percentage announced as the general rate increase. The second has to do with the way dimensional weight is determined. Many shippers were caught off guard with that rule modification and failed to appreciate the magnitude that change was going to make on their shipping budgets. Most likely it's the largest cost increase for shippers in our lifetime.

LM: ***How are market conditions affecting service and vice-versa? What role is the slow-to-recover economy playing?***

Martinez: Air and ground service performance has been strong. Over the past two years, both carriers have improved ground transit times by a day for hundreds of ZIP code pairings. The rationalization of transportation networks that came out of the financial challenges of 2009 has since been

rescinded, and carriers continue to make investments in their networks and expand infrastructure.

Ross: Market conditions are not affecting service levels. The slow-to-recover economy just allows the parcel carriers to adjust their networks slowly to changing demand levels. Interestingly, service disruptions would most likely take place if economic activity were to surge unexpectedly.

Hempstead: If you look at the sum total of packages available for the first nine months of this year among the big players, there's just no real organic growth to crow about. In the absence of organic growth, the carriers can do what they can to take costs out of their operations without compromising service—but the real net profit improvement has been from price increases.

LM: ***It's no secret that the USPS is "on the ropes" financially. What are the possible changes for the USPS that could affect shippers?***

Kahl: While I don't foresee a "shut down" of the USPS, I do predict higher prices for its customers. On November 8, 2011, the USPS informed the Postal Regulatory Commission its intention to seek an exigent postal rate increase above the CPI-linked price cap—one of several life preservers I believe the agency will be tossed. If UPS and FedEx can raise rates 4.9 percent to 5.9 percent every year, the USPS should be allowed to set market-driven increases as well.

Ross: The USPS is losing billions of dollars, but the bulk of these losses stem from an unusual pre-funding of retiree benefits for workers who have not yet even been hired by the USPS. Also, the organization's inability to appropriately size its business is causing the remainder of the financial strain. The U.S. government will not let the USPS become insolvent; so, while its current bottom line leads to the "on the ropes" characterization, it should also lead to some governmental action to allow the USPS to remain a viable part of the parcel industry.

Hempstead: Doug and David are both right on. Keep in mind that the USPS is a minor player in the grand scheme of things. Its most viable niche is the last mile delivery they do for FedEx Smartpost and for UPS Sure Post. There're some other players in the parcel consolidation space, but the sum of them pales by comparison to the two big consolidators. Parcel for the USPS is less than 15 percent of its operating revenue.

LM: ***What advice do you have for parcel shippers in the coming year?***

Martinez: Meet frequently with your carrier reps, challenge your carriers with ongoing rate improvement initiatives and zone skipping opportunities, and addend your pricing agreement as needed. Also take the time to develop a valuable relationship with your current carrier, but be sure to invite the non-incumbent carrier to participate in annual bids. Finally, explore using market experts if you think you might need help with contract negotiation, and take advantage of their complimentary benchmarking and market assessment.

Hempstead: First, stay informed. There are tools that will allow a shipper to determine the impact the announcement of the new rates will have on your particular book of business. The announcement of an "average" increase is a meaningless piece of information for any particular shipper. Second, don't be shy in putting your book of business out to bid. Carriers don't have a "right" to your business, they have an obligation to honor their contract with you—but you have a right to price your business to get your optimum combination of cost and service.

Ross: If shippers want to avoid paying more, pay attention to modal selection and make sure they're not paying for more than they need, especially for regional shipments. ground can be a great value, as UPS and FedEx have significantly improved service levels and transit times over the past several years. For example, a ground shipment from Baltimore to New York City will get there the next day, as will the air express shipment—just at a dramatically lower cost.

Kahl: Know and understand your distribution pattern and have complete and accurate visibility to all the components that make up the total cost of shipping. That means converting from paper data formats to electronic—that's critical. Given last year's dimensional calculation changes, shippers also need to pay closer attention to how they package their product. Also, the UPS-Teamsters contract comes up in 2013 so keep your eyes and ears open to information from both sides as they begin that negotiation.

LM: ***How much different could the parcel landscape be in five years?***

Ross: We don't see it being much different. B2C parcels will continue to grow faster than B2B shipments, as consumers order more online and collaborations between the big two and the USPS should continue delivering more of the B2C shipments.

Martinez: Hopefully, there will be greater competition in the U.S. market in five years. I would love to see the USPS fix some of service differences with UPS and FedEx to become a true third carrier option. Long-term parcel shipping trends—like the rise in residential deliveries as well as packages getting "lighter" and more regional—favor the USPS. In addition, it would be terrific to see growth in the regional carrier market to keep FedEx and UPS honest.

Hempstead: The big change in parcel has been the globalization of inventory placement. Many major corporations have already figured out how to keep inventory in places like China and using Chinese labor to pull, pack, and ship fulfillment orders. Then they can use consolidation into the U.S. and get the parcels into one of the U.S. networks like UPS, FedEx, and USPS. It's not going to be a surprise to see international volumes grow far greater over the next five years than domestic.

Kahl: The USPS financial situation will need to be dealt with, if not this year then certainly within the next five years. But anticipate that a regional carrier network will continue to gain traction in the market as shippers look for alternatives. I don't think people realize how much more expensive it's going to be to operate a carrier through the increased regulations of the current administration, ongoing security compliance, insurance rate hikes, and potential for independent contractor reclassification. So, look for rate increases to continue at a level equal to or greater than recent history. ☐

Logistics Management Exclusive Webcast

2012 RATE OUTLOOK

Wednesday, January 25
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2012 Logistics Rate Outlook: Flat...for now

While leading transportation analysts say that rates will be fairly level across all modes heading into 2012, they warn that a number of unanswered economic and regulatory questions could push them skyward if suddenly resolved.

What can shippers expect in 2012 in terms of rates and capacity?

Join Group Editorial Director Michael Levans, *Logistic Management's* Executive Editor Patrick Burnson, and a panel of leading economic and transportation analysts as they share their exclusive insight on where rates and capacity are headed over the next 12 months. Our distinguished panel will also take a closer look at the moves carriers will be making to stay the course and provide shippers with the services they require to achieve sustainable growth.

Attendees will gain a better understating of:

- The current state of the U.S. economy and its impact on freight transportation.
- Which way oil and fuel prices are likely to go in 2012.
- What to expect in terms of rates and capacity across all modes.

Moderators

Michael Levans, Group Editorial Director, Supply Chain Group

Patrick Burnson, Executive Editor, *Logistics Management*

Speakers

Oil & Fuel: Derik Andreoli, Ph.D.c., Senior Analyst at Mercator International, LLC

Trucking: John Larkin, Managing Director, Stifel Nicolaus

Rail/Intermodal: Brooks Bentz, Partner, supply chain transportation, Accenture

Air Cargo: Charles Clowdis, Managing Director for transportation, IHS Global Insight

Ocean Cargo: David Jacoby, President of Boston Strategies International

Parcel Express: Jerry Hempstead, President of Hempstead Consulting