



CHANGING THE SHAPE OF PRICING

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For parcel shippers, UPS's change in pricing for oversized packages at first seemed little more than a technical adjustment, a shift in a narrow range of business that could be easily absorbed.

But some shippers say they are trying to head off what could amount to significantly higher costs in the near term and industry experts predict even larger changes in the long run as UPS shifts its pricing for oversized parcels to a more fine-tuned, accurate and likely more expensive system of 'dimensional weight' measurements.

Ten percent or fewer of UPS package shipments may be affected directly, but parcel industry observers say the impact of the change will reverberate across domestic shipping, further blurring the already-fuzzy lines between air express and ground parcel services and even pressing changes in LTL operations and freight classification standards.

FedEx and DHL officials would not say whether their companies will respond to UPS's move, but industry officials say the very shape of pricing is shifting for shippers, across competing modes of freight transport.

The move to dimensional pricing for ground is 'redefining certain parts of the parcel business,' said Michael Regan, chairman of TranzAct Technologies, and is part of a larger move to target pricing through basic rates and the more focused add-on charges called accessorials.

'You are seeing the evolution of cost-based pricing,' he said. 'To the extent that a carrier can segment each part of the operation, they can charge more for each operational cost that the shipper causes them to incur.'

UPS would not specify how much volume would be affected, but said the oversize categories account for less than a million packages out of nearly 11 million its ground operations handle each day.

UPS spokesman Stephen Holmes said shippers have been asking for a simpler pricing method, and the new system 'really is simpler' for many shippers already used to that pricing model for air. Under dim weight pricing, for instance, there is no issue of where a box falls within an oversize, or OS, price range, for instance, or if it is on the cusp of the next pricing category.

But he said the change is part of UPS's ongoing effort to get its pricing 'more and more finely tuned' with the actual costs of handling each package. Dimensional weight pricing, he said, 'more accurately allocates the true cost' of handling and delivery.

He would not say if UPS expects to generate more income from the change in method, on top of its usual annual rate increase, but reiterated that until UPS introduces its 2007 rates no one can say how that will play out.

The new formula will target the lighter, larger boxes that take up more space with less weight or density, for years singled out under an OS rating. Under OS-1, OS-2 and OS-3, shipments over certain measurements of length, height and width added together jumped to rates based on 30 pounds, 50 pounds or 70 pounds. Under the new system, length, height and width are multiplied and then divided by 194, the so-called dim factor.

Tim Sailor of Navigo Consulting, a consultant to parcel shippers, said 'certain shippers' could see shipment costs rise by large percentages.

For instance, he said, a large box rated under the old rule at OS-2, or 50 pounds, would come in at 75 pounds under dimensional pricing. Traveling across the country, or eight zones on a UPS map, the price would jump from \$27.73 to \$36.43, or more than 31 percent.

That's likely at the far end of the impact, however.

Pittsburgh-based SJ Consulting estimates UPS's change will drive \$85 million in added revenue to the company, not a particularly large amount in UPS's overall revenue stream.

SJ Consulting said its shipment data suggests about 10 percent of UPS's oversized packages will see no impact, 30 percent will see lower prices and 60 percent will see some increase.

'By itself, there is not a large impact on shippers,' said Satish Jindel, president of SJ Consulting. 'But it is a start of a sequence of things that that will have a much greater impact.'

'This leads to the elimination of the differences between express and ground services in pricing and accessorials, which could lead to a single parcel service without a distinction between ground and express.'

LTL carriers also may respond, say experts, as the technology that makes segmented pricing, including dimensional weight measures, easier and shippers grow more accustomed to paying for cube.

'As costing models have gotten more sophisticated, parcel carriers have used that to align their costs and charges,' said Gail Rutkowski, director of transportation services at AIMS Logistics, a logistics services provider to high-volume shippers. 'LTL carriers up to five or six years ago didn't have such sophisticated costing models, but that is changing. LTL carriers, in order to stay competitive, are going to have to look more like parcel carriers.'

For shippers, the first response to the change is to look at the shape of their own shipping.

One shipper, Darren Forland, vice president of operations at The Forland Group, an Ontario, Calif.-based importer of toys, said analysis of his shipment data from a cubing measurement device showed his billable weight going up 11 percent. That will push him to cut the size of his boxes coming out of factories in Asia.

'Shippers have to do their own research,' he said. 'You have to be knowledgeable with your data.'

'If you're a parcel shipper, packaging is all you should be talking about,' said Rutkowski.

At Bear Stearns, transportation analyst Edward M. Wolfe said in a report that a major beverage manufacturer 'says that he will vigorously oppose the new pricing system and will stop using UPS Ground unless UPS concedes and agrees not to apply the new system to his company.'

But avoiding dim weight charges by going to other carriers may not be possible for long.

The dim weight model 'is being reviewed, considered' at FedEx Ground as well, as it prepares its own 2007 rates, spokesman David Westrick said.

He said FedEx is studying the big shift by UPS for 'what our response would be, how we should continue handling oversize rates and whether we should adopt a similar structure.'

In addition, freight industry sources said officials from both FedEx and DHL said at a mid-September parcel shipping conference in Chicago they were reviewing the UPS move before deciding their own rates for the coming year.

'I would expect that FedEx and DHL will adopt similar dimensional rules in January,' said shipper consultant Doug Caldwell, executive vice president at Parcel Pool.

Otherwise, he said, 'they run the risk of getting cherry-picked by shippers' as UPS under its new method retains packages with the most desirable cubic dimensions while the rivals are left handling more shipments with 'undesirable cube.'

In addition, all three face the same shipping economics, under which lighter and bulky items cost them more to carry than smaller, denser packages. Over-the-road trailers filled with packages 'tend to cube out [fill up] before they reach their maximum operating weights,' Caldwell said, forcing carriers to use more trailer loads to cover package weight.

Pricing software vendors are jumping in to offer shippers upgrades to help them plot the likely effects. Some packaging consultants are offering ways to send products with less bulk, and advising how to work down their shipments to different box sizes to come under the three-cubic-foot measure that triggers the formula.

Said one shipper who requested anonymity, 'I'm already telling my factory in China that has always packed up product at in boxes of five cubic feet that we have to cut that in half so I can be billed at 24 pounds.

'UPS is a great organization and they obviously studied this very closely. But there are some strategies that shippers can use to mitigate the impact of the change.'

Understanding and segmenting costs has become easier for carriers because of technology, but similar technology also can work for shippers. 'The reality is you have a battle of information going on,' said Regan. 'It's becoming a question of who understands their business better. In most cases, it's the carrier who understands their business better over time.'

That will be increasingly important, say experts, as new pricing strategies move into the LTL arena.

'The parcel guys are also in the LTL business now and they know how to use shipper discipline,' said Jindel. 'They are going to 'dim-capture' instead of using the classification system.

'After all, if you can capture dimensional weight for millions of parcel shipments a night, how far can you be from doing that for a few thousand LTL shipments?'

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