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Investigation of Methodologies Used by Less-Than-Truckload (LTL) Motor Carriers to Determine Fuel Surcharges

tech transfer summary

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RESEARCH PROJECT TITLE

Investigation of Methodologies Used by Less-Than-Truckload (LTL) Motor Carriers to Determine Fuel Surcharges

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This research investigated fuel surcharge practices of the LTL motor carrier industry to help the industry establish more consistent policies and better understand the benefits of surcharge utilization.

Objectives

- Identify dynamic influences that define the LTL motor carrier industry through interviews with industry leaders and identification of points of contention regarding fuel surcharges.
- Review existing literature to determine prevailing industry practices related to fuel surcharge policy development and implementation.
- Conduct qualitative research to summarize these findings and to identify areas of further study on fuel surcharge utilization.

Problem Statement

The less-than-truckload (LTL) motor carrier industry exists to serve the niche between parcel and truckload (TL) motor carrier transportation. In serving this market, LTL motor carriers exhibit characteristics of both parcel and TL motor carriers. Since deregulation, increased competition has become intense. Parcel carriers have been aggressive in capturing larger shipments, while TL carriers, in association with TL consolidators, have encroached on the higher end of LTL capacity.

In the midst of this competitive market, LTL carriers are paying particular attention to any cost or activity that serves to erode their profit margins, including activities that might have been considered a customer convenience (e.g., drivers assisting with loading or unloading freight), and are increasingly charging customers for these services. In addition, recent spikes in fuel prices have caused LTL carriers to incorporate fuel surcharges on their transportation invoices.

In order for motor carrier firms to better manage the impact of fuel and other surcharges, particularly related to handling customer relations, the industry needs a consistent pricing policy that enables motor carrier firms to quickly respond to changes in fuel prices.

Research Description

The intention of the research was to identify and understand the motor carrier industry decision makers and their behaviors at a detailed level,

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so as to provide clarity and transparency with regard to fuel surcharge design and implementation. To determine current management practices of the LTL industry, researchers contacted 39 of the largest LTL transportation companies in the LTL motor review. Only six (15.4%) of these organizations responded to researchers' interview request; however, these carriers represented 35% of the 2005 freight revenue listed on the Transport Topics Top 100 for-hire LTL carrier segment (TT 100 2006).

To further validate the study, a quantitative examination of published LTL carrier fuel surcharge policies has been conducted and utilized to cross-reference carrier responses.

Summary of Findings

Fuel surcharge policies represented a significant portion of the revenues received by LTL carriers because fuel expense represented a significant portion of their costs. It was impractical for carriers and shippers to revise contract rates each week due to a single volatile expense. Isolating fuel expense in a fuel surcharge policy reduced administrative overhead and kept the shippers feeling content with their steeper discount.

To develop fuel surcharge policies, carriers either conducted an elaborate analysis of their fuel costs to establish the basic components of the LTL fuel surcharge, or they waited to determine which fuel surcharge policies would become predominate in their market and imitated those to maintain competitive pricing. The large percentage of LTL companies utilizing identical fuel surcharge policies indicates that imitation is the prevalent method of fuel surcharge development.

The disparities among the operations and cost structures of the carriers with the varying fuel surcharge policies listed above suggest that fuel surcharge policies could potentially over- or under-compensate carriers for the actual incurred cost of diesel fuel. While carriers who responded to the survey did not dispute this possibility, they were quick to point out that any profit derived from fuel surcharge revenues is unintentional.

The most substantial finding that carriers repeatedly mentioned was that net transportation and fuel surcharge revenues were both considered when setting LTL transportation prices. Both components of the freight bill were negotiable. And as one carrier said, "Some shippers will present their own fuel surcharge. If the fuel surcharge is too low, that revenue will appear as a reduced discount." This transparency enables a more complete understanding fuel surcharges and provides opportunity to rebuild those relationships that may have been damaged through lack of information.

The academic literature firmly established the diversity of LTL motor carriers and their differences from parcel and truckload carriers. This diversity and the unique market conditions they face are likely the primary factors responsible for the lack of a single accepted standard for fuel surcharge policy development and implementation. The lack of standardized practices within an industry segment with similar market influences reflects a possible inefficiency and an opportunity to uncover and disseminate best practices found within that market.

By contrast, the popular press articles served primarily to identify the heated points of contention with regard to fuel surcharges and tend to focus on the recent trend of escalating fuel surcharges. Some popular press articles failed to identify the primary role of surcharges, instead focusing on rising fuel surcharges and ignoring the fact that surcharge policies are designed to respond to fuel prices. This means that fuel surcharges fall when fuel prices fall and rise when fuel prices rise, in accordance with the carrier's fuel surcharge policy. This bias toward the negative aspect of fuel surcharges is likely to skew the shipper's perception of fuel surcharges and, because it utilizes fuel surcharges, hinder the LTL carrier's ability to maintain positive customer relationships.

Implications and Future Research

Understanding the balance between the discount and the fuel surcharge enables the shipper to see the whole picture. The carrier takes into consideration both the fuel surcharge and net transportation revenues. Instead of feeling slighted by a fuel surcharge, shippers who move lower volumes of freight and are unable to negotiate their LTL rates should consider joining a consortium or partnering with a third party logistics firm to consolidate their low freight volumes with a group of shippers. The consolidated freight volumes provide leverage to negotiate with LTL carriers and positively impact their pricing because carriers can rely on more consistent, higher volume freight that enables them to maximize equipment utilization.

The academic body of knowledge regarding fuel surcharge policies and their implications is in its infancy. More limited still is the literature pertaining specifically to the LTL motor carrier segment. Investigation and publication of both costs and non-financial implications of fuel surcharge utilization are likely to improve understanding and acceptance of the necessity of fuel surcharges as well as help regain trust between carriers and shippers.