QTS

Rail Freight Procurement Strategies

White Paper: How small to midsize rail shippers can minimize expenses and maximize leverage

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The Problem

Shippers are becoming increasingly squeezed by North American railroads when it comes to the year-over-year costs of moving freight. It's a problem that grows annually, impacting shippers large and small and regardless of commodity, volume, and shipping patterns. To remain competitive in the marketplace, shippers must take action; utilizing whatever resources are available to them to gain leverage and minimize costs. For most companies, it's a never-ending struggle.

The Shipper: Limited Resources and Rail Expertise

Most large and many midsize rail shippers have freight procurement personnel in place. They often have the resources to employ a logistics department taking care of all their sourcing and procurement needs across multiple modes such as Rail, Intermodal, Truck, Barge, and overseas shipping.

Smaller companies on the other hand do not have the resources in place for transportation, or must are leave it up to their lean and overtaxed purchasing or shipping departments to take care of securing freight rates. Smaller companies must concentrate their limited resources on what they do best: produce and sell their products. They have no time for protracted freight negotiations; nor do they have the ability to fully analyze how competitive their rates are compared to the market. Additionally, knowledge of the rail industry and the inner workings of the rail carriers is a luxury that smaller shippers simply can't afford or can't find.

All of this puts the shipper at a distinct disadvantage in freight negotiations. When freight rates expire, the railroads often find shippers unprepared and without the necessary means to effectively combat oppressive annual increases. As a result, they are often forced to take quoted rates, absorbing the ever-increasing cost.

The Rail Carrier: Holding All the Cards

Railways, on the other hand, are always prepared. They are experts in the field of freight rate marketing and they know the rail industry. They have the resources to analyze rate and volume data, and can prepare for negotiations weeks or months in advance. And they know how to maximize the considerable leverage they have. A few of these are:

- The carriers have minimized the amount of competition they face in the market. The Class I railroads have quite effectively and strategically split the geography of North America between them; limiting the amount of actual head-to-head competition they face.

- The carriers have blunted the potential for competition through regulatory and legislative means. This limits the leverage of the so-called "captive shipper," who can only negotiate with one carrier, even when others are nearby.

- Generally railroads know their business and the freight market much better than their shippers and destination receivers – what kind of rates competitors are getting, are they closed or are they opened to competition, is it backhaul or head haul for them, how much volume is involved, etc. Armed with this information, they put the shipper at a distinct disadvantage.

- The carriers point to the ever-increasing volume of traffic on their lines, especially noting the boom in intermodal traffic to and from ports, and the recent explosive growth in crude oil traffic from shale oil.

- The carriers will often point out that they spend a great deal of revenue annually on infrastructure improvements and maintenance, and note that this is not subsidized by the Federal Government in the same way highways are.

- The carriers can point to the energy markets for increases blamed on the volatility in the price of crude oil.

All of these arguments and more are given by the railways, with documentation and statistics to back them up.

Rail Freight Costs: A Runaway Train

It is no surprise that rail freight rates balloon annually, and increase far faster than virtually anything else. Railways maintain that their rates are ***market driven***—rates as high as the market can bear. The higher the rate, the better, and the more profit for them. These rates are not ***cost driven***; they allow carriers to quote rates that can far exceed their actual operational costs. As a result, their margin, or revenue over variable costs (RVC), can be as high as 300% or more!

On top of that, railways levee a fuel surcharge and these revenues often go directly to their bottom line since any new rate quotes include the anticipated cost of fuel. Yet the carriers still insist on charging an added surcharge after the fact.

And as previously mentioned, railways know their market better than the shippers themselves at origin and destination and by specific commodity since they have the experience and the resources.

If left unchecked, and with little leverage to bring to bear, small and midsize shippers can find themselves in a real bind.

It is therefore up to shippers to challenge the railways at their own game. They must effectively dispute excessively high pricing demands, and get their pricing in line with reasonable expectations and those of their larger competitors via well-prepared and effective freight negotiations. Otherwise they are leaving profits, and potentially the long-term health of their business, on the negotiating table.

Potential Solutions

To combat this trend, a shipper has generally three feasible options to explore:

1. **Develop a Resource.** The shipper could develop an effective rail negotiating resource from their existing pool of team members, or add an employee to obtain the necessary skills. There are some limited training materials and references available, there are consultants and people to talk to, and of course there is the school of hard knocks and experience to help them.

   The benefit to the business would be the full-time access to a home-grown expert; knowledgeable of the shipper's industry, organizational structure, and the railroads. Unfortunately, an experienced traffic person takes time to develop, especially in dealing effectively with railroads. The process could take years to bear fruit. The shipper must also absorb additional overhead in personnel salary and benefits while continuing to consume unchecked rail increases while they learn. And there is the risk that the resource may not provide the needed relief, or may not reduce rates enough to justify their position, becoming a negative cost.

2. **Hire an Experienced Resource**. A shipper can hire an outside resource with proven experience in rail freight negotiation. This would potentially allow them to see benefits in a shorter time frame.

   However, finding a resource with the desired expertise and background can be a challenge. The number of individuals available with the specific set of skills is small and dwindling annually with retirements, and in addition to the investment of time and money needed to locate the resource, the shipper can expect to pay a premium in terms of salary and benefits to secure the talent. Only after that work is done can some relief be expected.

3. **A shipper can hire QTS.** Quality Transportation Services is a Third Party Logistics Company that specializes in the unique and complex challenges associated with freight rail transportation. With almost 40 years in business and a staff of experienced professionals, QTS can offer shippers a turnkey solution with a proven track record of success, and at significantly less cost.

   Our freight procurement team is made up on life-long railroad professionals, including former rail shippers and former railroad employees and sales professionals. We help shippers every day by leveraging our considerable experience, industry relationships, and software tools to give you the benefit of an expert in your corner at a fraction of the cost. Without the cost of trying to develop or hire an expert, a small shipper can stay lean and stay focused on what they do best--produce and sell their quality products.

Shippers need an aggressive, engaged, and experienced partner. That's exactly what QTS is for dozens of clients throughout North America.

The QTS Solution

At QTS, we have the **tools**, the **experience**, and the commitment to **service** to get real **results**. We can maximize your leverage to get the railways to consider more ***cost driven*** rate options.

We employ a team of knowledgeable and experienced professionals from diverse backgrounds as both shippers and railroad employees. We know the challenges, we know the contacts at the carriers, we know their methods, and we know what works.

Here's how we do it:

1. **Understand your business.** Step one is for our experienced procurement specialists to gain an understanding of your business. This includes your shipping origins, commodities, serving railroads, and shipment volumes (historical and forecasted) by lane. Additional information like industry trends, competitor position, legislative and regulatory changes, and other mode usage are also considered to gain a complete understanding of your unique business.

2. **Evaluate the present rate structure.** QTS experts will review your active rail rates against a proprietary list of factors and considerations. Utilizing specialized rate tools, we can then calculate expected freight spend, benchmark applicable rates against similar ones in the industry, and analyze opportunities. This provides us with a targeted strategy for negotiations. We can identify the lanes that are the biggest problems from a cost perspective, which have the most opportunity for cost savings, and where the shipper is competitively disadvantaged.

3. **Build your case**. From here, we develop an action plan for negotiations with a detailed analysis of the current market and the rate structure other shippers enjoy and how this impacts you and your relationship with the carriers. We don't look for ways to attack the carriers, but work to bring your case to the negotiations the way the carriers bring theirs. They will be prepared to tell you as a shipper why their rates must increase; you must be prepared to show them where and why they cannot with specific reasons and justifications. In short, it is very important to show the railroad carriers the importance of a shipper's business to their business, and how the pricing decisions they make impact both your bottom line and theirs. From there, we search for opportunities for

both the carrier and the shipper to benefit and grow through analysis and running "what if?" scenarios.

4. **Proactively negotiate on your behalf.** Using the case we've built, we engage in proactive and cooperative negotiations with the rail carriers to tell your story, "railroader to railroader." We address the sales contact and their marketing manager in the process to explain why rate changes will benefit them and work cooperatively to uncover options that work for all parties involved. Rather than engaging in a protracted tug-of-war that ultimately serves no one, we find the balance that maintains a productive relationship with the railway while also allowing the shipper the best chance to succeed.

5. **Ongoing Maintenance and Partnership**. QTS doesn't disappear once the negotiation process is complete. As your partner, we continue to watch your back as someone you can rely on and trust. We maintain our engagement with the carriers for you, negotiating new lanes and spot rates, keeping you abreast of regulatory, legislative, and carrier announcements and important changes. We participate in industry meetings and attend rail conferences to represent you and your interests. We provide commentary to policy makers, legislators, and agencies on your behalf. And if desired, we can of course provide you with other services to further help you maximize the value of rail for your business.

When it's time to renegotiate, we'll be there again to continue to build your case and be your advocate.

With QTS, clients realize cost savings of anywhere from 5% to 15% in the first year of negotiations, easily eclipsing the costs of our services by many thousands of dollars, a sizable return on investment.

Case Studies

Here are some recent examples of our successes:

- An international paper recycling company with multiple plants in the U.S. engaged QTS to help reduce their freight costs and audit their freight bills. QTS saved them over $900,000.00 in rail freight costs in the first year and a half on approximately 1,500 shipments.
- A beverage/denatured alcohol and ethanol producer with two US facilities engaged QTS to help reduce their freight costs. We saved them over $ 2.2 million on freight procurement in the first two years by negotiating freight rates on their volume of 800 shipments per month.

Savings Lead to Opportunities

Some clients find that the savings achieved through successful freight negotiations allow them to engage QTS in additional cost-saving services to further maximize their rail use and minimize their costs. For example, our clients have found that combining our negotiations services with our railcar tracking services and plant management software to provide them with additional benefits. The combination, all financed by simple cost savings, allow them to gain additional value via increased railcar throughput at the plant, daily operational visibility of rail shipments, and historical shipment analysis. These benefits allowed them to identify ways to more efficiently manage their traffic, satisfy their customers, and integrate with the carrier systems. The results were even more costs savings in reduced demurrage costs, increased railcar turns per year, and fewer unexpected issues. These benefited not only the shipper, but the rail carrier as well, which in turn leads to an even more cooperative freight negotiating session in the future, when rate reduction opportunities are harder to come by.

Additionally, QTS can audit freight invoices to confirm the negotiated rate is what's invoiced, and fuel surcharges, accessorial fees and other charges are accurately represented. One client saved over 100,000 in improper assessorial fees through QTS freight auditing services.

What can QTS do for you? Contact us today and let us know.

About QTS

Quality Transportation Services is a privately-held Rail Logistics Company headquartered in Mechanicsville, Virginia with satellite operations and sales offices strategically located throughout North America. Operating 24 hours per day, 7 days per week, we handle a wide variety of rail logistics needs such as shipment tracking, fleet administration, EDI data exchanges, freight procurement, invoice auditing, and rail plant management for leaders in industries such as Chemicals, Metals, Food, Aggregates and Forest and Paper Products. We have provided rail management services for over thirty years, continually enhancing and improving throughout our history to make our people, processes, and software more valuable and customized to our clients' unique needs.

We are called to serve. We serve our customers so that our customers can serve theirs, and achieve the goals and dreams they have for their businesses. At QTS, your success is our success, and as a trusted service provider, we aim to be a "dream enabler" for our clients. Therefore we never shy away from a challenge, and adapt as our clients' needs change, and as our industry, technology, and partnerships evolve.

It is our goal to contribute to your successes this year and beyond. We look forward to the opportunity.

The QTS Mission Statement:

> *"QTS is a rail logistics company which provides proactive service, asset management, and technology solutions. Our industry leading expertise enables QTS and our customers to maximize the value of rail to gain a competitive advantage."*

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