

Even before the terror attack on the United States, the air cargo industry was suffering from a dramatic economic cool-down all over the world. High wage settlements and rising fuel costs had put the market under pressure. Air carriers reacted by tightening flight schedules and trimming personnel costs. Cost saving has become the main management activity for saving or rescuing the business in recent weeks.

Profit Pressure in the Cargo Industry

Where is it most urgent, and how can carriers overcome it?

***By Kornelia Heusener
Gesa von Wichert***

But declining margins and profits are not every cargo carrier's inevitable destiny, nor is cost-cutting the most effective and durable solution to the current difficulties. Instead, the carriers need to understand the three factors that are keeping profits under pressure: overlooked pricing opportunities, lack of yield management, and unclear discount policies.

**Pressure point No. 1:
Overlooking the importance of pricing for premium products**

For several years, the cargo industry has had to cope with decreasing margins. Competition and the steady improvement of supply chain efficiencies have created a situation where simple transport services can be easily substituted. This puts even further pressure on prices and margins.

To avoid the substitution of their convenience products, most cargo airlines have decided to enhance the value of their services. The industry

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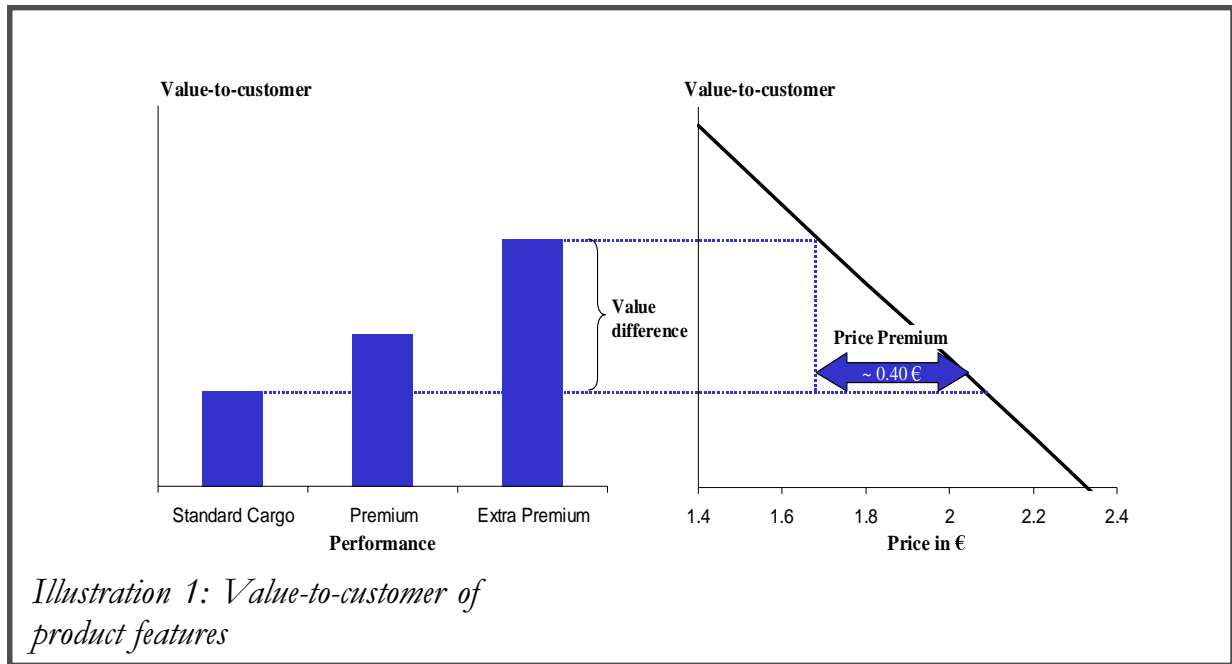
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has put a lot of effort into the introduction of premium products which combine existing products with added features such as speed or special transportation services for perishables or live animals. Nearly every European carrier has created its own express product such as KLM's "Select", "td.Flash" from Lufthansa Cargo, or "Equation" from Air France Cargo. These premium products will become the cargo carriers' main profit drivers, because the performance differences from carrier to carrier create a high potential for price differentiation which does not exist for regular core products.

A problem occurs when - as in many endeavors aimed at improving the service performance - the main focus is on product/service optimization at the expense of marketing aspects, especially pricing. Pricing is often completely ignored. The price potential of many new high-value products has rarely been recognized, never mind exploited. Many decisions are made according to gut feeling. When critical price components such as the "value-to-customer" and his "willingness to pay" are not taken into account, the oversight can cost the carriers millions in lost profit potential. A price difference of 1% - 2% can easily lead to a profit difference of 50% - 60% per item.

The key challenge is to identify the optimal price premium for high quality products in comparison to the standard cargo. To do this, companies need to analyze in detail the value which the customer places on each single product feature such as speed, capacity access, reliability, or price. Indirect techniques such as conjoint measurement are appropriate for gathering this information, which can be used to precisely determine each customer segment's willingness-to-pay on a feature-by-feature basis.

Investments should be undertaken only for product features that the customer really appreciates and



for which his willingness-to-pay (and thus, the profit-optimal price) is significantly above the cost level.

Pressure point No. 2: Lack of a strict yield management

What makes the integration of the price components "value to customer" and "willingness to pay" difficult is that the value of product features might vary from season to season. Guaranteed capacity is not very important during the off season, but becomes a valuable feature at peak times.

Yield management is a very important subject for the entire transport industry, but in comparison to passenger airlines and their sophisticated tools, the cargo industry's yield management is still very underdeveloped. The improvement potential is vast.

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Especially when there are no general mechanisms in place to maximize revenue and optimize capacity on a day-by-day basis, the risk that profit potential will be sacrificed is substantial. Frequently, unsystematic mechanisms like "constant minimum capacity access prices" are used. These broadly defined prices are set only once or twice a year. Such a sea-

son-independent average price minimum can guarantee neither the usage of capacities in low seasons nor revenue/price maximization in peak times.

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In a situation where margins are under pressure, price optimization and revenue maximization are very important tasks. Even the smallest profit potential has to be identified and professionally exploited. Price optimization and revenue/yield management are closely related, but nevertheless two different functions that should not be mixed up. Optimized prices of different service levels are the necessary basis for an effective, profit-generating revenue maximization. The figure below illustrates the different tasks of these functions. However, both departments should work closely together. Their goal is identical: to maximize the profit.

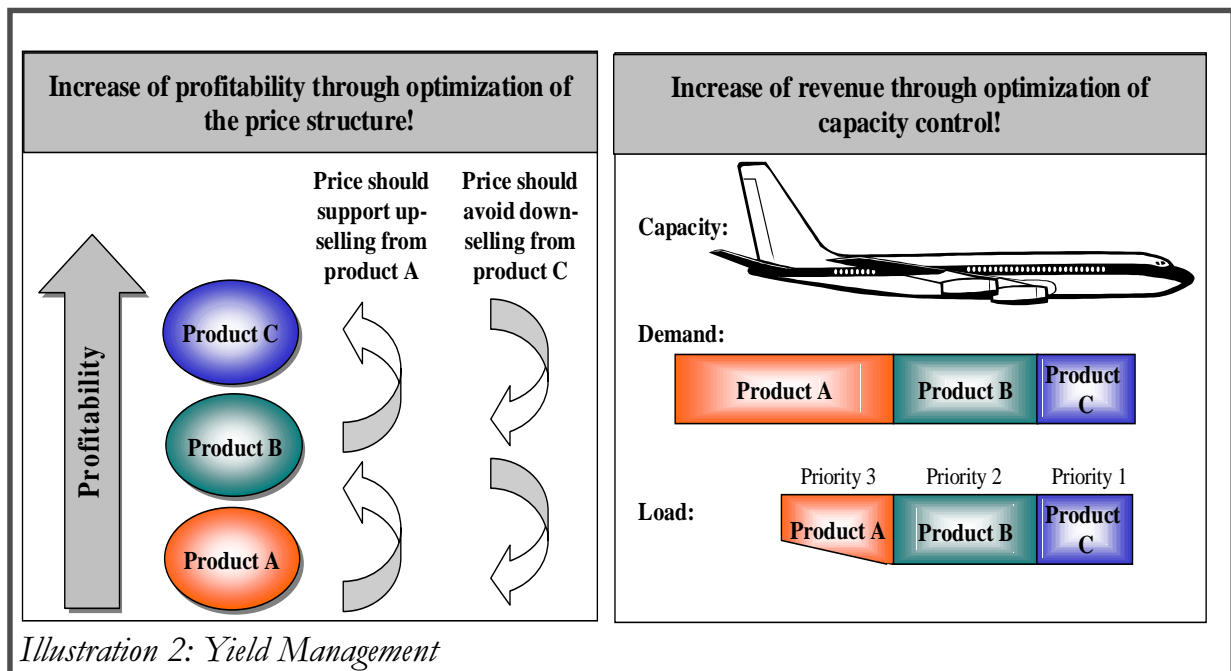


Illustration 2: Yield Management

Pressure point No. 3: Lack of a clear discount policy

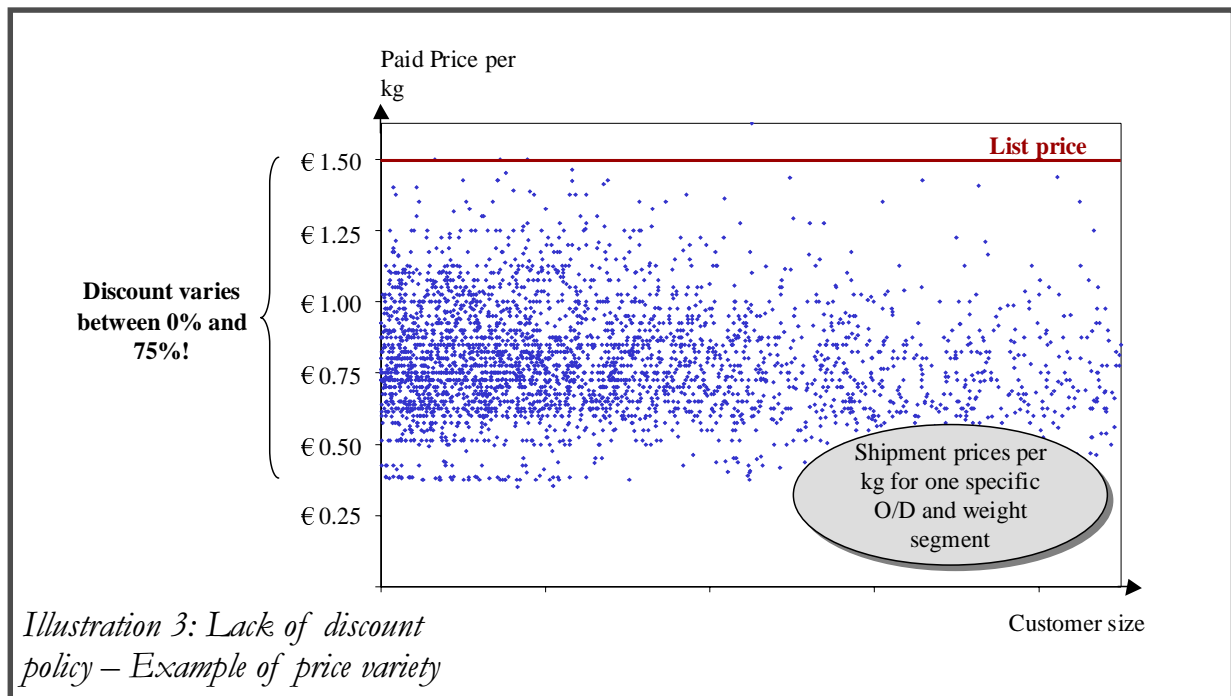
The lack of a stringent discount policy is probably the biggest single problem in the logistics market. Too often the carriers do not have a clear systematic regarding the discounts they give, which means that the sales force in many cases has no guidelines concerning the appropriate discount level for a specific business.

We have experienced that not only in the air freight industry, but also in many other logistic companies, list prices are rarely used. Instead, prices are more or less individually negotiated with the sales reps. If the sales rep has no guidelines, no framework, and no discount ceilings to work with (which is usually the case), then management has no more influence on prices at all. Even the best optimized tariff lists are nothing but waste paper. In many companies, millions of Euros get lost through uncontrolled high discounts (see figure below)

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As a first step it is essential to identify the criteria which should determine different discount levels: should discounts be given depending on the number of shipments a customer sends within one specific period? Or on his tonnage? On the destination of a shipment? As long as these criteria are unclear, it is not possible for the sales force to offer optimal prices to the customer.

This loss of money could be stopped quickly through implementation of discount guidelines in combination with an efficient price controlling cycle.



Setting maximum discount levels could turn the least profitable business into a more profitable one without decreasing prices for businesses where discounts

tend to be lower. The millions of Euros that could easily be earned with a clearer discount structure would – after implementation - require little additional costs, which means they flow directly to the bottom line. That alone would put most of the cargo companies back in the black again.

Conclusion

Many companies have let considerable profit potential slip away because they succumbed to the industry's profit pressures. Escaping from these pressures - or avoiding them altogether - will lead to a more sustainable profit outlook than cost-cutting.

Kornelia Heusener is a senior consultant with Simon-Kucher & Partners, a global strategy and marketing consulting firm. Gesa von Wichert is a consultant with the firm. They work in the firm's Transport & Logistics Competence Center.

For more information:

SIMON ♦ KUCHER & PARTNERS

**Haydnstrasse 36
D-53115 Bonn
Germany**

**Tel: ++ 49 228 9843 315
Fax: ++ 49 228 9843 320
kheusener@simon-kucher.com**

**Bonn
Vienna**

**Boston
Zurich**

**Paris
Tokyo**

**Munich
London**