
Despite a drop in margins, optimistic forecasts are giving transportation and e-commerce experts a reason to expect enormous profit increase for distribution specialists in the courier, express and parcel markets (CEP market). The most important reason for this profit margin downturn is not rising fuel costs, but the more or less avoidable mistakes made by pricing managers. This article identifies some of the most common pricing pitfalls in the express and parcel delivery market.

Pricing Mistakes in the CEP Market: Lost Profit

All logistics service providers face basically the same challenges: rising fuel prices and taxes, traffic jams, and, last but not least, an increase in costly stop-factors caused by the growth in B2C deliveries.

But instead of keeping prices at a constant level (or even trying to transfer these costs to the customer!), prices actually dropped. Since 1996, average prices in B2B delivery decreased by roughly 15-20%! Salespeople - driven by turnover-based incentive systems - struggled to acquire and keep every customer – much to the detriment of profits. Our experience shows that most pricing systems lack consistent orientation towards logistics cost drivers.

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Moreover, pricing managers within the logistics industry have failed to exploit opportunities to raise prices.

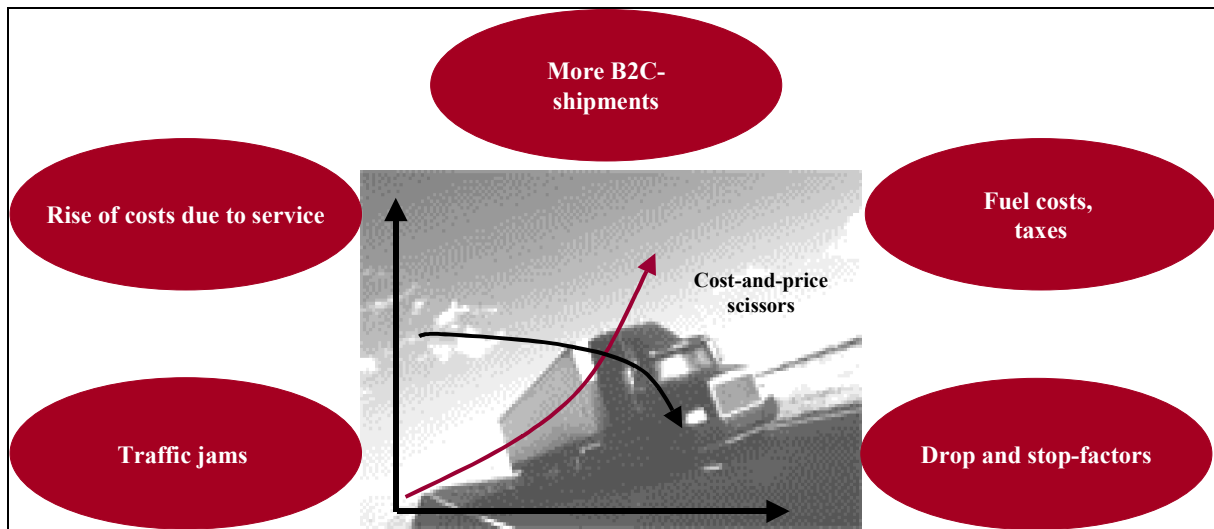


Fig. 1: Cost-and-price scissors in the CEP market

What pricing strategies could bring profitability back to the express and parcel services sector? Some topics for discussion:

Weight-based Pricing...

Of course it makes sense to differentiate parcel prices according to their weight. The additional costs for delivering a 30-kilo parcel compared to a 5-kilo parcel are negligible, and everyone in the transportation industry knows about this. Most customers blindly accept higher prices for heavier parcels. Another advantage is that linear pricing schemes are easy for the customer to understand.

One of the most common mistakes pricing managers make with linear pricing schemes is that they price lighter packages too low to avoid having to set prices that are too high for the heavier packages.

Pricing managers often look at the overall scheme and try to find acceptable average prices – strongly neglecting the fact that more than 90% of all shipments are low-weight shipments. High prices in the upper weight bands cannot compensate the lost profit incurred in the lower weight bands. With this kind of shipment and pricing structure, the overall contribution margin is unsatisfactory.

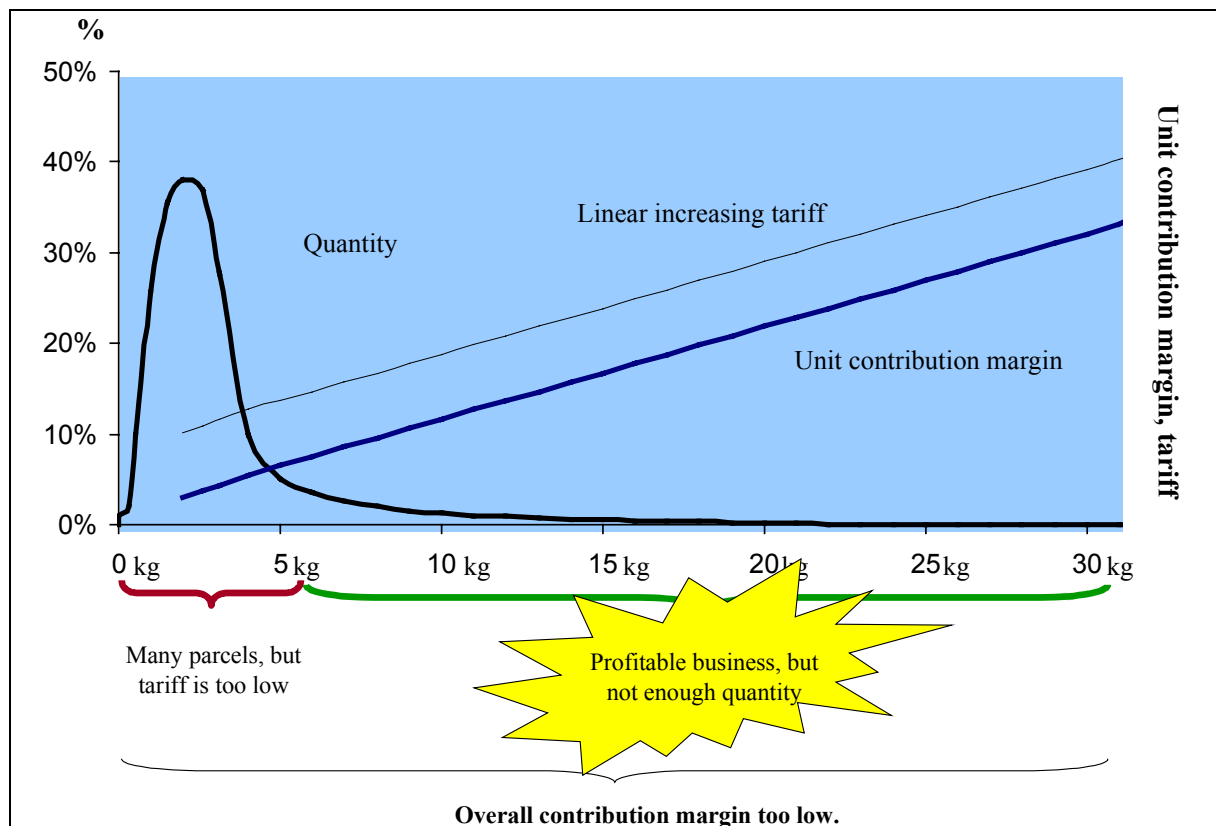


Fig. 2: Overall contribution is too low due to linear pricing scheme

Lesson 1: Instead of using linear pricing schemes, use degressive schemes based on a profit-optimal price for the lower weight bands.

... or Volume-Pricing?

The limited capacity of pick-up and delivery vans makes it even more important to take the volume of the parcels into consideration.

While the weight (ranging from 1-30 kilos) does not affect the profitability of a delivery tour, the volume of the parcels does. Some mail-order companies allow key accounts to pay a flat rate (independent of volume) for each parcel. Consequently, the packaging department is likely to select the more convenient, easier to pack larger boxes. As a result, the parcel service often has to use an additional van or make a second delivery run. This leads once again to higher costs.

Lesson 2: Due to limited handling or delivery infrastructures, pricing schemes must take parcel volume into account. Avoid flat rates!

Some remarks about rebates

Of course, most key accounts will not be satisfied unless they are offered special rates or rebates. But the key message in this context is: Don't rebate without reason! We believe that rebates are justified only if the customer makes a significant contribution toward lowering the service provider's costs. An example clearly illustrates rational and irrational quantity discounts. Customer A has to ship 16,000 parcels per year. Without significant fluctuations, approximately 300 parcels have to be shipped each week. Customer B also ships 16,000 parcels per year: 10,000 in December, 4,000 in April and the rest on an ad-hoc basis throughout the course of the year. Traditional incentive systems force the salespeople to give the same rebate to both customers – based on quantity and turnover. But when examined more closely, it becomes clear that Customer A is a much better client than Customer B. Customer A makes it easy for the

parcel service to calculate tours, personnel and loading rates – in other words, he lowers costs. Customer B, on the other hand, needs to be served with extra capacities in December and April, which generates cost peaks and requires additional planning. So why should Customer B benefit from the same rebate?

Lesson 3: Rebate schemes for major customers as well as incentive systems for the sales force need far greater differentiation. They should take not only quantity and turnover into account, but also the cost-reducing characteristics of the customer.

Timing of rebates and bonuses

Our experience shows that shippers are very good at underhandedly negotiating the lowest possible rates. During the yearly bargaining with the service provider, a shipper might announce that they will require 10,000 shipments for the following period. The salesperson naturally accepts the respective quantity discount starting with the first parcel that has to be shipped. But even if this shipper truly has 10,000 parcels, he would most likely give the parcel service a significantly lower quantity. For the remaining packages, he would negotiate special rates with a second or third service provider. It is virtually impossible for the first service supplier to get his money back after having given a volume discount in advance. This “cherry picking” behaviour has become the norm throughout the industry. A recent study by Simon-Kucher & Partners revealed that 65% of all shippers never reach the number of parcels they promised by the end of the year.

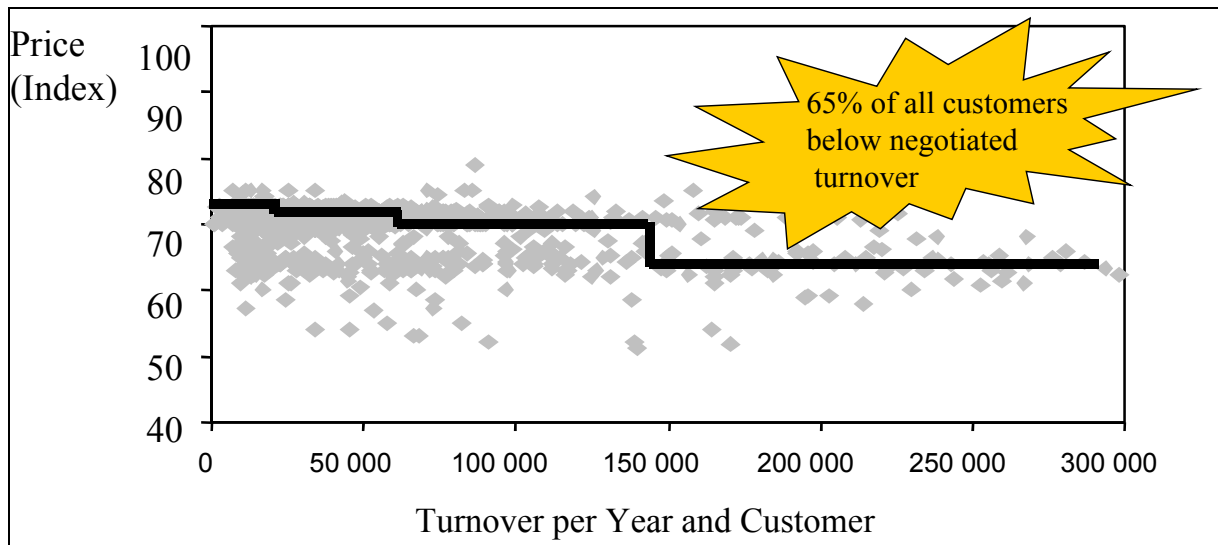


Fig. 3: Study finding: 65% of all clients never reached promised quantity

Lesson 4: Discounts should be implemented as ex post rebates. This is the only way to avoid frustrating discussions between shippers and service providers concerning the gap between promised and realized quantity.

Back to pricing intelligence

During the past few years, express and parcel services have been champions in bringing down prices lower than their competitors'. In retrospect, this price war has caused great damage to the industry as a whole. In such narrow markets, price changes lead to immediate competitor reaction. The result: When the price war is over, market shares are left nearly unchanged – but industry price levels and profits are down. This phenomenon, so common in many industries today, shows that pricing in the CEP market has been relatively myopic during the past few years. One reason for this might be the strong growth strategies of the major national postal organizations, such as Deutsche Post World Net, Royal Mail or La Poste.

But at the end of the day, profitability has decreased in all market segments. The situation is very similar in the telecom industry: call-by-call providers lowered prices nearly every week – and now some of them are facing bankruptcy.

What alternatives are open to express and parcel services? Intelligent industries make use of “signalling”. Market leaders announce in advance what they intend to do, namely increase prices due to externalities such as rising taxes, fuel costs etc. With this kind of market communication, the customer is more likely to accept a price increase. From an economic point of view, it is necessary to foster a climate for higher prices in order to keep a sufficient amount of players in the industry.

Lesson 5: Intelligent industries use “signalling” strategies – not price wars.

CONCLUSION

The examples mentioned clearly indicate that there is not a magic formula for pricing in the express and parcel services sector. Pricing must be adjusted to the individual mix of customers, destinations, quantities and peculiarities of the shippers. Pricing and incentive systems must come back to cost causalities. Powerful pricing in the CEP industry is not a trivial matter. It requires thorough analysis and highly individualized optimization calculations. Let's see if providers will find their way back to intelligent pricing.

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