The Freight to Finance Translation Guide:

A CFO Primer on Transportation's Impact on Financial Performance

A PLS Logistics White Paper

Transportation costs unquestionably impact a company's financial performance. And yet, for most CFOs, controlling these costs sits far down on the priority list. Despite strong evidence that better collaboration between Transportation and Finance leads to more informed and smarter decisions, active collaboration is rare. Why? Because CFOs and logistics managers view transportation through a very different set of lenses.

While CFOs evaluate strategies based on the impact on profitability, asset utilization, and other company-wide metrics, logistics managers focus more on their own departmental budgets and metrics and don't always communicate the broad consequences of transportation decisions up and down the line. As a result, CFOs can get a false read on the financial impact of transportation and logistics decisions.

BOTTOM LINE: Transportation strategies need to be evaluated using a wider financial frame, while recognizing the interplay between these strategies and the key financial levers that shareholders and Wall Street pay attention to. If CFOs are from Mars and logistics managers are from Venus, here's the transportation view – translated into terms that the CFO can understand.

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One area where CFOs and logistics managers can agree is the value of freight savings. For a $1 billion industrial company with a 5% profit margin, a 10% savings on freight transportation can add about $6.3 million to the bottom line, a 12% profit increase.

The trickier part is in understanding the full financial impact of transportation decisions, since transport and logistics costs are spread out over many different divisions. The share of the pie taken up by transport-related costs can't be represented with a discrete pie piece – it's actually a tiny sliver of personnel, pension, insurance, safety, financing, and many other costs. To get a clearer view, several key questions related to transportation and logistics strategy have been identified. Let's look at how a company's answer to each can impact financial performance.

How Much Inventory Should You Carry?

The pressure is on all over the world to reduce the amount of inventory tied up in supply chains. For more than a decade, the buzz word has been "lean".

However, leaner inventory means faster transportation, which can command premium rates and drive up other costs. Trucks are faster than barge and rail, but they're more expensive, not just per mile, but in terms of loading costs.

To a CFO, lean inventory means "reduction in working capital tied up in inventory." But to a logistics manager it means "greater need for expedited freight, complicated changes in transport mode, plus pressure for 100% accurate fulfillment."

Typical impacts of lower inventory include:

- Higher freight costs because it precludes the use of cheaper, longer-transit modes, and may even require paying a premium for expedited freight.
- Stock outs. On the inbound side, this can cause plant or production line shut-downs due to lack of raw material or parts. On the outbound side, it can lead to empty shelves, missed sales or, at worst, the loss of a customer and the associated lifetime revenue.
- Increased labor costs to rapidly process the inventory, monitor stock levels and arrange transport for urgent restocking.

In pure financial terms, inventory is a component of working capital. While it continues to be difficult to borrow money, Wall Street is keeping a very close eye on levels of capital tied up in the supply chain – the lower the better. However, if you take your inventory, and therefore working capital, too low, your profit margin suffers. That alone looks bad, but if in addition you have to raise your working capital levels again, investors may react negatively to volatile inventory.

BOTTOM LINE: Reductions in working capital related to inventory carrying costs should be balanced against potential for increased freight charges and lower customer satisfaction levels caused by stock-outs. A decision to reduce inventory can negatively impact operating margins and drive down revenue, which will reduce overall profit. In other words, when you examine all the logistics implications, it's possible that lowering inventory levels can COST you money.

How Does Transportation Impact the Pursuit of New Commercial Strategies?

CFOs are intimately involved in evaluating new business strategies. Too often, however, transportation is an afterthought in these evaluations, despite the fact that freight costs can significantly impact the viability of new commercial programs. For instance, expansion to a new market may require costly creation of supply lines that don't exist. Reducing order-to-delivery cycle time to achieve a competitive advantage means faster, more expensive modes of transport.

Evaluating payback on new business strategies requires an accurate read on transportation costs, which can account for a good chunk of an industrial company's operating costs. It behooves the CFO to have a more granular understanding of these costs and how they are determined. Unfortunately, lack of clear communication between logistics and finance can result in a false read.

Take the issue of carrier rates. The lower the rate, the lower the cost to the business, right? Well, not necessarily.

For instance, late deliveries can erode customer confidence and threaten revenues. Or, carriers may quote a low rate to win the business but then, during implementation, add hidden "accessorial" charges that drive up the bill. Accessorial charges common in the industrial sector include:

- Fuel surcharges – allow the hauler to be reimbursed for excessive fuel costs
- Tarping charges – for placing a tarp over cargo on a flatbed
- Truck order not used – charged when freight is booked but the shipment must be delayed due to weather
- Detention – charged to shippers for delayed return of carrier equipment

These and other charges make it difficult to do an apples-to-apples cost comparison of carrier rate quotes since accessorials vary from carrier to carrier and some may include these in their quote, while others may not.

A mid-sized construction materials manufacturer shopped rates aggressively and thought it was optimizing it's freight spend. However, a competing quote from a third party logistics company uncovered extra charges that made the carrier 20% more expensive from a total cost perspective. The following chart compares the rates for a single move, from Chicago to Baltimore, with an actual load/unload time of five hours.

Some carriers add "common" charges to the rate, but these are not necessarily common

Fuel surcharges are not standard across the industry

	Linehaul Cost	Fuel Surcharge	Tolls	Tarping Charge	Detention charges	TOTAL COST	Percent Savings
Chosen Carrier Rate	*$1,155*	*$280*	*$180.02*	*$25*	*$300*	*$1,940.02*	
Alternate 3PL Proposal	*$1,211*	*$242.20*	*Included*	*Included*	*$100*	*$1,553.20*	*19.9%*

Amounts of allowed free time for loading/unloading and the cost of detention can vary

BOTTOM LINE: Carrier RATES don't always equate to COSTS. CFOs need to collaborate with their transportation colleagues to understand the true cost of transportation and the impact of these costs on the viability of new commercial strategies.

What Balance of Fixed and Variable Costs Should be Maintained?

Managing transportation requires people, equipment, and systems. They can live on your books or someone else's. While CFOs may see divesting non-core assets such as a fleet of trucks as good business, logistics managers may see this fleet as critical to reliability and maintaining customer satisfaction.

Again, the "buy or rent" decision is clouded by the fact that TOTAL costs are difficult to decipher. Costs are spread across multiple P&Ls and are never linked back to the decision to acquire the asset. Private fleets are a good example. The following chart lists ALL of the costs associated with fleet ownership.

Direct Fleet Costs		Indirect Fleet Costs	
• Driver pay • Fuel • Lease • Insurance • Cell phone • Permits & licenses • Taxes • Tolls • Fines	• Garaging • Maintenance (tires, oil, parts, emissions compliance, washing) • Equipment (tarps, chains, etc) • Hotels • Systems • Uniforms	• Systems support • Dispatch/fleet mgmt • Risk/Compliance mgmt. (auditors and mgmt. compensation, log books, DOT reg. handbooks, substance abuse prevention, recovery programs) • Recruiting (recruiter compensation, advertising, screening and qualification, drug testing) • Driver orientation and training	• Maintenance (shop personnel and mgmt. compensation, parts inventory, shop tooling depreciation, shop vehicle, fuel island expense) • Buildings and terminals • Legal and professional services • DOT record keeping (periodic inspections) • Insurance • Utilities • Bad debt accrual

A major factor in fleet ownership that many CFOs don't consider is risk. Should an accident occur, it's you, not a carrier, who is liable. Lawyers get involved and start asking tough questions about your safety program – one that, very likely, is not as robust as a quality carrier's safety program.

When you examine risk management and all the other costs related to owning assets that could be outsourced, on balance, it's a good idea to consider divesting as much as possible. Often true costs of a dedicated fleet are not allocated. For example, the fleet doesn't always have it's own insurance and may just be piggy-backing on the corporate insurance policy.

Business volatility also tips the scales in favor of outsourcing. When business slows, the relationship of assets to revenue becomes unbalanced. Outsourcing transportation to a logistics company – one that provides the required people, carrier capacity, and systems – helps manage this volatility by allowing your costs to parallel your revenue stream. Other financial advantages of being asset-light:

- Avoid fixed costs for labor and systems
- Avoid pension obligations and other personnel costs
- Lower SG&A expenses
- Improve return on assets
- Gain fast access to extra capacity to support unexpected or future growth

A $250 million steel company hit a business downturn and found itself shipping a third of the volume to customers, but still paying the same for transportation administration. Working with a third party logistics provider (3PL), the company shifted to a variable cost model where they pay the 3PL a per-shipment charge. If nothing ships, there is no charge. This variable cost solution helped the steel company weather this downturn, but also came into play when business picked up and the 3PL's large carrier network was needed to support market expansion.

BOTTOM LINE: CFOs need to work closely with logistics managers to figure out what level of in-house assets will best serve the company's needs. To make this decision, it's critical to understand the total cost of owning transportation-related assets, such as a truck fleet or software system, and carrying a full-time professional and administrative staff.

What Freight Terms Make the Most Sense?

The personnel who make decisions about buying materials and parts, and about who pays for delivery, are not always aware of the impact of these decisions on the business. For instance, products that are sold "Freight Collect" require the customer to arrange and pay for shipment from your facility. While this reduces your staffing burden and shields your profit margin from fluctuating freight charges, it can also wreak havoc on your operation. Customers that may not be experts in transportation are now forced to coordinate with your warehouse or factory to schedule pick-ups. If badly managed, this can create chaos at the dock. Also, Freight Collect terms can lead the customer to use your facility as its own warehouse. You lose control of when inventory leaves your hands and, crucially, when you can invoice and get paid.

On the inbound side, Freight Collect terms can backfire in a different way.

> *For one manufacturer of tubular steel products, a buyer within the Purchasing group decided to take advantage of a favorable buying opportunity for raw steel, but it came with the condition that the company must take immediate possession of the goods. According to the firm's logistics manager, "The deal looked great to Purchasing and Finance, but what we gained on the pricing side, we lost in added transportation and storage costs for products that arrived and just sat. You have to look at the total costs."*

Other points to remember about freight payment terms:

- If the outbound terms are "Freight Prepaid and Add," the good news is you don't have exposure when freight rates go up. You simply pass those increased charges on. But, if the freight charges go down, you miss out on those savings.
- If you opt for "Freight Prepaid" terms, you are responsible for managing line-item freight costs, which can increase manpower costs. But if you manage your freight network more efficiently and manage to reduce freight bills, you keep the savings.
- On the inbound side, buying "Freight Prepaid" means vendors simply pass on the freight charges to you, so there's little incentive for them to minimize these costs. Some may even use freight as a profit center. Managing inbound freight moves yourself can yield significant savings. By improving on the vendor's performance, you can save up to 25% in inbound freight costs. For a company spending $60 million a year on these costs, that translates to $15 million in savings.

BOTTOM LINE: When it comes to freight payment terms, CFOs must carefully weigh what happens if the company relinquishes control of where and how products enter or leave the facility.

What About Transportation Management Technology?

When it comes to transportation management technology, great strides have been achieved in harnessing the data-crunching power of computers and the accessibility of data facilitated by the Internet. However, running such a system in-house puts you in the software maintenance and training business. This typically involves upfront investment in integration and implementation, as well as commitment to a technology that might not fully fit the evolving needs of your company.

Third-party logistics firms have their own systems and tend to be at the leading edge of technology adoption. So outsourcing tends to bring better, more up-to-date logistics technology. What a CFO needs to realize is that when the transportation manager says he wants to buy a transportation management system, he is really saying he wants to pursue an in-house logistics strategy.

The CFO should understand all the implications, on cost and company strategy, before deciding to purchase transportation management software.

Closer Collaboration between Freight and Finance is Key to Reducing the Total Cost of Transportation

Freight strategies can have a material impact on the financial ratios that board members and Wall Street use to assess the value of the company. For this reason, truly effective CFOs learn to collaborate closely with the company's logistics or supply chain team to understand these strategic opportunities.

Increased collaboration between Freight and Finance will most likely involve building new metrics and setting new standards for evaluating decisions. If you're not measuring it, you can't control it. As one CFO put it, "Without transparency to the total cost, it's difficult to uncover the best opportunities to save."

While Finance and Transportation departments may not speak the same language, CFOs can and should learn to understand the different levers and balances that form the relationship between transportation and the company's bottom line. A significant opportunity awaits the company that can better understand the complete financial implications of transportation strategies and make decisions accordingly.

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About PLS Logistics Services

PLS Logistics is one of America's largest freight brokers and the largest third-party logistics provider to the industrial sector. The company's 20,000 pre-qualified carrier partners give shippers access to over 150,000 trucks; including the largest network of flatbeds in North America.