IMPACT OF FREIGHT POLICIES ON PROFIT & LOSS

Many companies implement freight policies to help offset the cost of transportation. But an intelligent freight policy may also be an effective means of managing the profit margin for each customer relationship. There are two types of policies: a freight recovery policy is a set of rules that a company uses to determine how much it charges customers for freight costs; a free freight policy waives freight charges if a dollar threshold or order quantity is met. These policies can significantly impact a company's P&L, or profit and loss statement, and as such must be carefully considered, regularly reviewed and actively monitored.

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Freight Recovery Policy

A well-designed policy can help recover costs and improve profit margins; whereas a poorly designed, unmonitored or outdated policy can lead to unintended losses. A variety of interrelated factors must be considered when designing a freight policy, including:

- type of freight
- quantity and weight of orders
- distance traveled
- mode of transportation
- inbound freight
- cost of fuel
- cost of labor
- insurance
- fulfillment expenses
- desired margins

The goal of this policy should be to ensure you achieve desired margins. But it must also be fair to the company's customers. A freight recovery policy that is too aggressive may result in lost customers. Finding a balance that both maximizes order quantity from "platinum" customers while protecting margins on average orders is critical.

Free Freight Policy

Shipping charges are waived because an order quantity or dollar threshold has been surpassed in a free freight policy. This policy can be a powerful incentive for customers to make a purchase by absorbing an additional cost that can deter them. Removing this barrier can drive higher sales and revenue for the company. Free freight policies can also be offered to valued customers to increase customer loyalty and repeat business. Finally, if your competitors are not doing it, a well-designed free freight policy can create a significant competitive advantage. Like any policy, it must be crafted carefully and enforced properly. Companies that use a free freight policy should define the expected impact the offer will have generating new orders and new margins. The reward must be worth the risk. Even if sales increase, profit margins may be squeezed if the cost of shipping outweighs the benefits of increased sales.

With either approach, careful monitoring and active adjustment are critical to success, and those abilities are greatly enhanced through using tools like a TMS to ensure proper carrier selection, shipping points, accessorials, classes and weights. See how it all can come together in these examples.

Transportation Facts	
1 Policy Per Company	
Freight % Sales	**7.8%**
Total Sales	$10,000,000
Freight Spend	
Gross Freight	$1,400,000
Net Freight	$775,000
Spend Breakdown	
Inbound Freight	$500,000
Outbound Freight	
Free Freight	$400,000
Non-Free Freight	$500,000
Freight Recovery	
Prepaid & Add	-$500,000
Prepaid & Add Margin	-$125,000
Additional Savings Opportunities	
Procurement	-$70,000
Wrong Carrier	-$40,500
Wrong DC	-$20,250
Shipping Errors	-$60,750
Increased Prepaid & Add Markup	-$40,500
Potential Net Freight	**$543,000**
Potential Freight % Sales	**5.4%**

Ingredients: Shippers, 3PL Partner, Carriers, vendors, customers, technology

ACHIEVING 100% OF RECOVERY GOAL:

In this example, we are recovering 100% of the freight that is not part of the free freight program. In addition, we are marking that freight up 25%. This leads to a freight % of sales of 7.8%. Towards the bottom you can see there are plenty of opportunities available to save more that could bring the total down to 5.4% if acted upon.

ADDING 10% PROCUREMENT SAVINGS:

Frequently, when a company sees profit margins declining because of higher freight costs, they may hastily assume that reducing rates is the solution. This graphic demonstrates how a 10% freight savings will reduce inbound and outbound freight expenses; however, the recovery policy and margins will move in-line as well, resulting in a minimal change in freight as a % of sales.

Transportation Facts	
1 Policy Per Company	
Freight % Sales	**7.0%**
Total Sales	$10,000,000
Freight Spend	
Gross Freight	$1,260,000
Net Freight	$697,500
Spend Breakdown	
Inbound Freight	$450,000
Outbound Freight	
Free Freight	$360,000
Non-Free Freight	$450,000
Freight Recovery	
Prepaid & Add	-$450,000
Prepaid & Add Margin	-$112,500
Additional Savings Opportunities	
Procurement	$0
Wrong Carrier	-$40,500
Wrong DC	-$20,250
Shipping Errors	-$60,750
Increased Prepaid & Add Markup	-$40,500
Potential Net Freight	**$535,500**
Potential Freight % Sales	**5.4%**

Ingredients: Shippers, 3PL Partner, Carriers, vendors, customers, technology

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Transportation Facts	
1 Policy Per Company	
Freight % Sales	**4.8%**
Total Sales	$12,500,000
Freight Spend	
Gross Freight	$1,260,000
Net Freight	$594,450
Spend Breakdown	
Inbound Freight	$450,000
Outbound Freight	
Free Freight	$270,000
Non-Free Freight	$418,500
Freight Recovery	
Prepaid & Add	-$418,500
Prepaid & Add Margin	-$125,550
Additional Savings Opportunities	
Procurement	$0
Wrong Carrier	$0
Wrong DC	$0
Shipping Errors	$0
Increased Prepaid & Add Markup	$0
Potential Net Freight	
Potential Freight % Sales	
Ingredients: Shippers, 3PL Partner, Carriers, vendors, customers, technology	

HOLISTIC APPROACH:

In this example we're going to improve our profitability, grow revenue, and enhance the customer experience. This is done by capitalizing on all the opportunities listed in the prior examples, improving the customer experience by reducing lead times with faster service. Using lower cost carriers means we can increase the markup to non-free freight carriers generating margin while still benefiting the customer. Adjusting the free freight policy will push some freight to the non-free freight program but customers will continue to spend to hit that limit driving up your total sales.

Effective freight recovery policies must be actively monitored and updated to reflect changes in the market. By making proactive adaptations in response to market fluctuations, companies can minimize losses on freight expenses and enhance their overall profitability.

At KDL Logistics, we work with our clients to help craft and enforce these policies, ensuring a positive outcome. Please visit us at kdlog.com or email us at sales@kdlog.com to find out more.

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