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January 2011 | [List all 3PL Line articles](#)

Balancing Shipper and Carrier Interests

by **Mark Laufer**

The past two years have been a roller coaster ride for both carriers and shippers. After the financial crisis, carriers dropped their rates to unprecedented levels. Service contracts locked in these non-compensatory rates, and volumes dropped precipitously. Ocean carriers took ships out of service, and capacity cuts were steep and drastic. The financial viability of many carriers was called into question.

Fast-forward 18 months, and the scene is much different. Carrier profitability bounced back to near-record levels. Rates recovered, and, to the dismay of shippers, carriers increased rates and levied surcharges. Shippers still can't get freight on ships, creating major disruptions to supply chains worldwide.

Shippers and carriers have wasted no time blaming each other. Who is at fault? And what can supply chain managers learn from this state of affairs?

THE PARTNERSHIP MYTH

The answer is simpler — and harder for carriers and shippers to accept — than it appears. Simply put, the idea of partnership in the shipper/carrier world is a myth. The new world of supply chain management requires that carriers and shippers both understand and respect the economics of the industry.

Capacity, the product supplied by transportation carriers, operates as a commodity market. When supply is high and demand is low, rates drop without regard to the return on investment required for the asset's long-term health. Carriers should recognize that peaks and valleys in demand will even out over time, and shoot for price stability. But historically, that hasn't happened. As soon as capacity exceeds supply, carriers lower their prices.

Similarly, shipper behavior is essentially predictable. A company faced with hard economic times will squeeze every possible penny from

transportation costs — without consideration for the carriers' need for an adequate return on investment.

Carriers have to control capacity, pricing, and their costs to guarantee that the swings between rates in good times and bad do not put them in serious financial trouble. They will learn this discipline only when they stop fooling themselves about their supposed partnerships with customers, and recognize the relationship for what it is: self-interested economics on the part of supplier and customer.

Shippers must ensure they have a reliable source of "supply." They need to know the relationships they have are strong enough to guarantee the supplier will stand by them in bad times and provide capacity in a strong market. That means paying a compensatory rate — not necessarily the lowest.

LESSONS LEARNED

Carriers traditionally forget their bitter lessons the moment the market turns strong. They go on buying binges, increase capacity without regard to realistic growth prospects, then collapse their pricing when they can't meet expectations.

Shippers would happily squeeze carriers to the lowest possible rate level, place too much reliance on one carrier (usually the one with the lowest rate), and feed secondary vendors only when their primary vendor fails. This combination predictably yields the lowest cost for transportation on paper, but the worst performance for the shipper.

Both sides have to understand they can't always get what they want. But perhaps by working together, both parties can get what they need.

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