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a national network of transport carriers

A White Paper

Decreasing the profit margins of property brokers

How Shippers can reduce freight costs by 15% or more?

Introduction and Summary

This white paper discusses how shippers can still reduce truckload freight costs further by decreasing current gross profit margins, compensation and profits of property brokers and third party logistics companies (3PLs).

Historical Background

The Motor Carrier Act of 1980 deregulated the motor carrier industry. ICC restrictions on the entry of transport firms limited competition and kept prices high. During regulation transport carriers were allowed to establish rates that would recover their total cost of transportation that included a reasonable return on invested equity. Deregulation ended all that.

Deregulation was to introduce a greater degree of economic efficiency and competitiveness to the market place. Many new carriers entered into the trucking industry. Motor carrier authorities rose from 5,910 in 1976 to 33,548 in fiscal 1984. They have steadily increased ever since.

Deregulation created downward pressure on rates. Discounts and across-the-board cuts became commonplace. There is not a great deal of information on shipping costs since deregulation, but a survey found that average truckload rates for shippers declined by 25% between 1977 and 1982. Less than truckload rates showed declines of 15% over the same period.

Shippers have not reaped all the benefits of deregulation.

One could conclude that shippers have maximized all the benefits from deregulations. This white paper examines this proposition and perception more closely and concludes that shippers have still not reaped the full benefits and concludes that under deregulation third party property brokers and intermediaries are now reaping the gross margins, compensation and profits from deregulation.

One economic fact undisputable

Transport carriers have been unable to obtain a fair return on capital.

Since deregulation asset-based transport carriers have not been able to reach sufficient revenues to cover their full costs of transportation to include a fair return on invested capital under regulation. After tax return on invested capital became negative in 1981 and 1982 and inadequate returns on invested capital have remained ever since. Wall Street now consistently rewards non-asset based, publicly traded transportation brokerage companies with greater stock price to earnings ratios than asset-based publicly transport carriers.

Gross Profit Margins moving to non-asset based intermediaries.

Gross Profit Margins shifting to non asset based intermediaries

Growth of non-asset based brokers, freight forwarders and logistics intermediaries (3PLs) must be examined to analyze where the margins and returns on invested capital are going. Shippers can then determine if lower transportation costs can still be accomplished.

Let us examine how the law defined property brokers, how the law states they should operate and the current business model they currently use to increase their gross margins, compensation and profits.

Then we will examine how shippers can move to doing business directly with transport carriers to improve efficiencies, lower freight costs and insure continual competitive prices using new technologies called on line Smart Freight Directories®.

Defining Property Brokers

Title 49 Part 371 of the Motor Carrier Act of 1980 is the legal authority to establish **_property brokers._**

Part 371.2 defines a broker as:

(a) A person who, for compensation, arranges, or offers to arrange, the transportation of property by an *authorized motor carrier.*

Shippers must focus on the key words in the law: **_arranges or offers to arrange the transportation of property for compensation._** The law by definition merely defines brokers as persons (corporations, partnerships, LLCs, proprietorships or other legal entities) who arrange, or offer to arrange the transport of property **_for compensation._** By definition they are not authorized motor carriers. They are simply service companies that arrange and offer cargo **_for compensation_** to authorized transport carriers (motor carriers). The asset based transport carriers that actually move the freight.

Nowhere in the law is **_for compensation_** defined, limited, regulated or even discussed. Nowhere in the law is arranging or offers to arrange the transportation of property defined. Therefore the property broker model and law is evolving. http://www.carrier411.com/duediligence.cfm

Intermediaries are merely persons who, for compensation, arrange, or offer to arrange, the transportation of property by an authorized motor carrier.

In order to give the legal "property broker" name definition and to cover a larger group of licensed and unlicensed transportation facilitators the Transportation Intermediaries Association was formed. TIA, a member organization calls them generically 3PLs (Third Party Logistics) companies. TIA defines 3PLs as facilitators that arrange for the efficient and economical movement of property and goods. This association has taken on the mantra of establishing the generally accepted professional standards and ethics for unlicensed and licensed property brokers.

What brokers are not

The second part of 371.2 defines what brokers are not.

(a) Brokers are not motor carriers, or persons who are employees or bona fide agents of carriers within the meaning of this section when they arrange or offer to arrange the transportation of shipments which they are authorized to transport and which they have accepted and legally bound themselves to transport.

Property brokers are not motor carriers

The law is clear and courts have ruled that ***Brokers are not motor carriers.*** Further Section 371.7 (b) of the law states that a broker shall not, directly or indirectly represent its operations to be that of a carrier. Any advertising shall show the broker status of the operation.

Shippers unable to determine compensation of Intermediaries

Shippers are unable to determine compensation of Intermediaries

The legal definitions of Brokers in Section 371.2 (b) and (c) are so generic and unclear that shippers today cannot determine if they are over compensating intermediaries. Unlike state real estate agency laws where Single Agency, Dual Agency with Two Agents, Dual Agency with Same Agent, and Transaction Agents are well defined Property Broker federal law simply states in Section 371.2:

(b) Brokerage or brokerage service is the arranging of transportation or the physical movement of a motor vehicle or of property. It can be performed on behalf of a motor carrier, consignor, or consignee.

(c) Non-brokerage service is all other service performed by a broker on behalf of a motor carrier, consignor, or consignee.

Under federal law shippers today are unable to determine reasonable compensation for their services. They must make their own analysis.

What then are property brokers and intermediaries?

All property brokers are transaction brokers.

Substantial all freight property brokers and intermediaries operate as transaction brokers. Transaction freight agents do not represent either party and do not purport to or subscribe to any professional code of ethics that legally binds them to protect the interests of a seller/shipper nor a buyer/transport carrier of the freight transaction. They are simply licensed to facilitate and arrange the freight transaction ***for compensation.*** Or as one large publicly traded company states in their annual report, "*Our gross profits are the primary indicator of our ability to source, add value, and sell services and products that are provided by third parties, and we consider them to be our primary performance measurement. Accordingly, the discussion of our results of operations focuses on the changes in our gross profits.*

Under deregulation the compensation is not defined and the intermediary has no dual agency responsibilities, therefore ***the amount of compensation for the services rendered*** is left up to the broker's ability to source, add value, arrange for, purchase, sell and negotiate the price for the transport of the freight transaction and provide the necessary contract paperwork for all parties to the freight transaction.

Let's examine their business model. Is it value added or compensation driven.

Intermediaries have just three major costs: purchased transportation costs, personnel costs and administrative costs.

First and foremost they have sales and marketing staff to solicit freight transactions. They purchase freight transactions from shippers at the lowest possible price and then resell those freight transactions to transport carriers at an even lower price. ***Their compensation is measured by* gross revenues less the direct costs to transport freight hauled by transport carriers…their gross profits.**

The table below summarizes what gross profits brokers/intermediaries have been able to realize under deregulation.

Intermediary gross margins have steadily increased since deregulation

Per dollar of freight revenue	**2008**	**2008**	**2008**	**2008**	**2008**
Gross Margin Range	**Reasonable Target**	**Low Range**	**Mid Range**	**High Range**	**Highest**
% of brokers in range	**17%**	**20%**	**20%**	**27%**	**16%**
Gross Revenue	**100%**	**100%**	**100%**	**100%**	**100%**
Contracted Transport Costs	**90%**	89% - 86%	**85%**	86% - 80%	75% - 70%
Gross Margins per TL	**10%**	11% - 14%	**15%**	16% - 20%	25% - 30%
Personnel Expenses	**6.5%**	6.9% - 7.0%	**7.0%**	7.1% - 7.7%	7.8% - 8.6%
Sales/administrative expense	**2.2%**	2.2% - 2.3%	**2.3%**	2.3% - 2.4%	2.4% - 2.5%
Profit before taxes	**1.3%**	1.9% - 5.0%	**4.7%**	6.6% - 9.90%	14.8%18.9%
Federal and State Taxes	**.5%**	0.7% - 1.5%	**2.0%**	2.3% -3.47%	5.2% - 6.6%
Net profit after taxes	**.8%**	1.2% - 3.1%	**3.3%**	4.29%-6.44%	9.6%-12.3%
Percent profit on gross margin	**8.4%**	**11.2% - 21.8%**	**24.7%**	**26.8%-32.2%**	**38.5%-41%**

With regulation transport carriers, service routes and rates were determined for shippers through the regulatory process. There was a limited need for them. Intermediaries have now become the new middleman or gate keeper. Sales, marketing supporting staff and management personnel now act as the new remarketers in the procurement and execution of freight transactions. They keep personnel and other operating expenses as variable as possible. After contracted purchased transport costs compensation is their only substantial operating expense, is generally always performance-oriented and based on the profitability of individual efforts of the broker and staff. They have pre-committed targets for headcount growth. They try to maximize gross revenue per employee and minimize their cost of transport to maximize their net profits. They strive to keep their largest operating cost, purchased transport cost, as low as possible to maximize the gross margin and compensation out of the freight transaction.

Do the off the top dollars represent dollar value added

A broker's purchased transportation costs is then the transport carrier's gross freight revenue. The transport carrier's gross revenue is then gross revenue less the broker's management, sales and marketing, supporting staff and management costs and net profits taken ***"off the top" of the freight transaction.*** How do net profits translate into value added dollars for the shipper and the consumer?

With increasing "off the top freight dollars" going to intermediaries for facilitating, arranging and contracting for freight transactions shippers need to find alternative solutions to the current Freight Transacting Business Model.

How the Current Freight Transacting Model works

Since deregulation property brokers have marketed and sold shippers on the concept that by their purchasing, facilitating and arranging for the freight transaction and then reselling the same freight transaction to the transport carrier ultimately insures the guarantees the shipper the lowest freight price. That would be true if the shipper knew the gross margin before or after the freight transaction.

The current problem with the freight transacting model

Shippers' do not review brokerage gross margins before the freight transaction nor ask to review the gross margins subsequently. Unless the shipper as a party to the transaction, under the law, asks the broker the gross margin on the freight transaction the broker has no obligation to disclose up front. Conversely unless asked a freight broker has no obligation to disclose to the transport carrier what the shipper paid.

Very few, if any, freight property brokers ever disclose such information to either party. Once a freight transaction is purchased by a freight broker, the broker is free to use whatever media, system, business acumen, negotiation skills or other means to make as much gross profit margins and correspondent compensation as possible. ***Thus gross margins, compensation and profits have continued to increase since deregulation.***

The Current Business System

Since a freight property broker cannot by law directly or indirectly represent its operations to be that of a motor carrier numerous free and subscription based on line load boards provide brokers and logistics companies the advertising broadcast media they need to communicate the freight transaction multiple times to multiple places.

Substantially all of the advertising is targeted at the "spot market." The spot market is that fertile ground where brokers can negotiate and maximize the largest gross margins. The spot markets are the "spots" the broker will find transport carriers with available load capacities. Freight brokers know where there are more transport carriers with equipment capacity than freight. They also know that many small carrier drivers get tired waiting at the "spot" for a load and are getting stressed to get back home to their family where generally a good paying load is waiting. Each year thousands of transport carriers go out of business hauling freight brokered out of spot markets. In many of these spots brokerage margins can reach as high as 30%. In testimony before the Congressional Committee on Transportation examples were given of margins as high as 60%.

Shippers need a model where they can create their own spot markets and go directly to transport carriers without the use of intermediaries.

In addition the current transaction model and system creates a frenzy of inefficient, wasteful and labor intensive activity. Multiple freight transaction quotes are received from multiple brokers. Some shippers sense their 3PL is unable to form meaningful and trusting relationships. The shipper is double and triple checking by using multiple brokers to be sure they are being treated fair and reasonable in the pricing of the transaction. Duplicative freight transactions are posted on multiple load boards by multiple freight brokers. Once the freight transaction is broadcast and advertised to transport carriers multiple start again. Fax machines and e-mail runs hot and heavy. The phone rings continually. Well after the freight transaction has been arranged and contracted.

During the negotiation process communications are often times froth with oral misrepresentations, cancellation misrepresentations, sudden and unexplained driver and equipment failures by transport carriers finding a better load opportunity, unclear pickup and delivery times and lack of clear communications about the terms and conditions of the freight transaction.

Shippers need a more efficient and effective transport system that goes directly to the transport carrier who ultimately gets the freight moved.

How a new Online Smart Freight Directory® business model works

Many shippers are now choosing to not outsource logistic services because costs have not been reduced. Logistics outsourcing has become too important. Freight transaction control has been diminished and logistics personnel do not have the expertise, time and effort needed. Further service levels have not been realized and customer complaints have increased because transport carriers are not receiving adequate revenue streams to accomplish adequate service levels.

Now On line Smart Freight Directories offer technology opportunities to go directly to transport carriers without using outsourced freight brokers.

Smart Freight Directories use the new Applied Microsoft.Net Framework programming and internet technology where on line applications can be built, packaged, deployed and self administered. It is virtual freight transacting marketplace where freight transactions can be efficiently and effectively administered, facilitated, arranged and contracted for using one or more Online Smart Freight Directories®, one for the shipper and one or more for your transport carrier community.

Shippers need a more efficient and effective transport system

The Smart Shipper Freight Directories is designed for rapid deployment of loads and shipments for biding, tendering and arranging movement of freight directly to your transport carriers. The other Smart Transport Carrier Directory contains all the transport carrier paperwork, ACCORD forms, authorities, safety information or other data the shipper requires for the freight transaction an on line, completely paperless environment.

Smart Freight Directories are designed for rapid deployment, dissemination and exchange of information in a freight transaction. Smart Freight Directories are completely self administered and require no web development experience.

Here are some, certainly not all, of the applications that can be created at an online Smart Freight Directory.

- Create your own freight market spot. A spot where parties to the freight transaction find you. You do not have to find them. Brokers, intermediaries, consignors, consignees and transport carriers can find all the freight transaction information at on or more of your freight directories. Directories can provide documents, publicly or requiring user, name and password authentication.

- Create a proprietary or public load board where all parties to the freight transaction are routed for completion of the facilitating, arranging and exchange of documents to the freight transaction.

- Create a virtual private network of transport carriers to tender or bid on freight transactions and require transport carriers to have paperwork uploaded and made available at your freight directory location.

- Create a collaborative shipping network where shipments are originating from and make information available for Transport Carriers to pool, aggregate, consolidate or co-load shipments for reduced freight rates. Transport carriers and brokerage firms alike can quote or bid on your freight transactions.

- Create your own network of transport carriers that will compete directly for you freight without use of a brokers. Save 10 to 28% on brokered freight transactions.

- Save time and expense on making and taking telephone calls and sending faxes. Every freight transaction is handled totally electronically at your freight directory.

- After freight transaction is completed download all documents into an electronic file for reference and storage.

CONCLUSION

Today the constraint is not technology, but rather the inability of many organizations to access the alternatives and effectively integrate the technologies. The process begins with the understanding of the options, matching them against your specific requirements and then formulating a prioritized plan for moving ahead. It is clear that cost reductions have not been realized by use of brokers and many 3PLs and there is evidence of gross margin, compensation and excessive profit "creep."   3PLs are not keeping up with advances in information technology, and that technology capability is now available for shippers to subscribe to and use Shippernet.com's on line Smart Freight Directories®, to create their own electronic freight marketplace and facilitate, arrange and contract for their freight transactions with little or no need for a brokerage arrangement.

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