A Greater Than Report
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Analysis of the European Road Freight Market

Business Models and Driving Forces Influencing its Carbon Footprint

The haulage industry operates with slim profit margins. Could this be why it does not prioritise fuel savings? This is perhaps a somewhat paradoxical question but upon closer analysis, the market is more complex than anticipated. However the solution is simple.

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May 2011

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Abstract

Trucks are driven in a manner that leads to 15% - 20% higher than necessary fuel consumption, despite recent technological advances. Therefore, the sector's CO_2 emissions continue to grow. An evident performance gap exists as the process of Driver Fuel Efficiency is not currently being adequately controlled, in contrast to efforts to improve energy efficiency in other industries in Europe. This situation is due to current business models within the road freight transport sector that completely de-incentivise fuel savings.

Fuel is a major cost item but, in reality, a minor business concern to transport providers (hauliers) and third party logistics providers (3PLs). Current business models place fuel responsibility on transport buyers (such as retailers).

Following current business models, transport buyers assume responsibility for the cost of fuel, thus they should also ensure that transport providers and 3PLs maintain a process that delivers the best in fuel efficiency.

Summary

The challenge of meeting the objective of increasing fuel efficiency by 15-20% in the haulage sector is particularly great, since only 8% of the market presently considers fuel savings a priority.

In addition, buyers' sourcing requirements are at best neutral and at worst counterproductive to their intentions to reduce consumption and by extension CO_2 emissions. Some transport markets operate with business models and buying conditions that not only create resistance to fuel savings but actually de-incentivise them. This causes unnecessarily higher fuel consumption, which further damages the environment. As transport buyers assume the responsibility of fuel cost, they should also ensure that transport providers maintain a process that delivers the best in fuel efficiency. The process *Driver Fuel Efficiency* can easily be addressed by obliging transport

providers to answer the simple question: “What is your current fuel consumption and how does it benchmark against the standard Good Practice driver performance?” in doing so this worrying trend in fuel inefficiency can be curbed, immediately contributing to the drive towards a low carbon economy.

Introduction

Road freight transport is one of the few sectors in Europe that continues to increase its CO_2 emissions. The industry operates on slim profit margins despite the fact that freight represents a relatively small proportion of the cost of goods sold. Low profit margins should normally lead to a greater focus on costs, particularly on fuel, which represents a large proportion of total transport costs.

It is clear that transport providers pay very close attention to fuel efficiency when investing in new trucks. The technology behind engine performance and fuel consumption is a very important criterion for the purchase of a new fleet. Similarly transport buyers pay very close attention to a haulier’s fleet engine performance, fuel consumption and euro class engine when selecting a supplier. Both transport buyers and transport providers are concerned with the technology of fuel efficiency but not the process performance.

In this analysis we would like to explore the mechanisms and business models that govern the road haulage industry and ultimately challenge this logic. We have sought to understand:

1. Why profit margin is low despite the fact that:
    a) Transport providers place a large emphasis on price?
    b) The cost of freight is a relatively small proportion of the total cost of the goods sold for the transport buyers?
2. Why only 8% of the haulage and 3PL companies prioritise fuel reductions, meaning that 92% do not?

Over the last 18 months we have visited 1,112 road haulage and third party logistics (3PLs) companies from 17 European countries. Each visit concluded with a short questionnaire, which has helped us to establish a clear picture of current market conditions. The following report presents a detailed analysis aimed at understanding current haulage business models.

The report is broken down into four sections:

1. Why profit margins are low? : Examining current causes and influencing factors for low profit margins in the road freight sector.

2. Why 92% fail to priorities fuel savings? : Establishing the reasons why fuel is a low business priority.

3. Environmental consequences: Explaining the link between fuel efficiency and CO2 emissions impact.

4. Conclusion

Why profit margins are low

The reason why profit margins in the road freight transport sector remain low is influenced by several factors.

The first influencing factor is that 89% of all road haulage companies operate without any financial goals. The industry competes on price and simultaneously works without financial goals, which leads to minimised resistance to price reductions. Without the guidance of financial goals, it becomes difficult to understand what the true price of haulage is and should be. This leads to competitors’ prices becoming the standard rather than attempts to understand the real haulage economy. A vicious

circle is created and vital drivers towards price cuts are absent as a result.

The second influencing factor is the 3PL´s business model: a model usually based on commission or management fees. This means that turnover is more important than margin and cost. This again leads to competitors' prices becoming the standard and little resistance to price cuts in a race to win contracts. These two factors have created a market almost without barriers and no resistance towards price cuts. However, when competitors cut prices, managers are forced to cut prices themselves in order to remain competitive. Competitive advantage at any cost has become more important than aiming to achieve a defined profit margin.

FACTS BASED ON 1,112 QUESTIONNAIRES
89% operate without profitability targets 98% operate without cost saving targets 92% don´t prioritise fuel savings

Annex One has been included to present all the data collected from the 1,112 questionnaire.

Why 92% fail to prioritise fuel savings

Ambiguous ownership and the shared responsibility of fuel cost is the reason why the carbon footprint of the road haulage industry remains high compared to many other industries.

The main reason why hauliers do not prioritise fuel reductions is due to current business models, where hauliers directly pass on the cost of fuel to the customer. Fuel consumption is calculated through experience and the price is based upon an index; a direct consequence of this is that the cost of fuel becomes a minor issue for hauliers.

A further consequence of this ambiguous ownership of "cost and process" is the lack of clear incentives to reduce fuel cost. Current business models were developed in order to cope with various oil crises in Europe, where large fluctuations in fuel price could have potentially bankrupted the haulage sector.

Prevailing business models in the haulage sector are by definition preventing improvements in fuel efficiency, demonstrating the failure of the shared fuel responsibility that currently characterises the haulage market.

The haulage sector has three key actors: a) transport providers (hauliers), b) third party logistics providers (3PLs) and c) transport buyers (such as retailers).

a) Transport providers pass on the cost of fuel to the buyer; hence they have limited incentive to reduce fuel consumption, which is supported by 92% of hauliers admitting to operating without any fuel saving targets. This is a consequence of not operating with financial goals and consequently decreases focus on cost reductions. The lack of financial goals creates a commonly held fatalistic view regarding cost and profitability problems, which are perceived to originate from low prices rather than efficiency in the control of cost. The main cost items such as fuel and wages are perceived as external and impossible to influence.

   Currently there are two main types of contractual agreement used between transport buyers and transport providers:

   - Under open book contracts, transport buyers agree a fixed operational margin with transport providers, who have no incentive to reduce fuel costs as they are sheltered by the protected margin.
   - Under fixed price contracts, both parties agree on a fixed price per unit but the price is protected with fuel escalator clauses and resulting cost increases are passed on to the transport buyer.

b) Third party logistics providers add a commission on top of the haulage cost, again resulting in limited incentive to reduce fuel consumption. As large logistics companies outsource the haulage part of the value chain and operate on a commission basis, this gives rise to the wrong incentives because the higher the overall cost to the transport buyer, the higher the commission for the 3PL.

c) Transport buyers require fuel and CO_2 reduction efforts such as driver training; however limited attention is given to actual *Driver Fuel Efficiency* achievements beyond such training.

Though these requirements are not wrong, no end results are demanded, thus these exercises keep hauliers busy with additional training rather than achieving meaningful improvements.

Unfortunately, the means have become more important than the end result, and in many ways lead to an obstacle in actual CO_2 improvements.

With the combination of these influencing factors, fuel saving has become a 'non-issue':

1) Divided responsibility between the fuel cost and the process.
2) A fatalistic attitude towards costs.
3) 3PL´s commission and management fee based income.
4) Buyers not demanding that the *Driver Fuel Efficiency* related performance gap be closed.

As a consequence, fuel consumption is excessive and CO_2 emissions remain higher than necessary.

Environmental Consequences

The actual consequences of road freight providers not prioritising fuel savings are hard to estimate. However, one established outcome is that trucks are driven to 15-20% higher than necessary fuel consumption in concrete terms, which signifies that, per year, an average long distance diesel truck produces 19 tonnes of unnecessary CO_2 emissions (140.000km and 35l/100km).

Conclusion

We are not condemning current business models. The aim of this report is to highlight how various market factors collaborate and lead to increasing environmental impact. Within a complex market such as haulage, it is vital that transport buyers and sellers understand how business models and other influencing factors work in order to better position themselves.

This report has been pier reviewed by nine haulage companies, four 3PLs and six transport buyers. No errors in fact or content have been found.

As transport buyers are responsible for the fuel cost, they should demand a process that delivers the best in fuel efficiency. A simple corrective measure would be for transport buyers to demand results to be achieved rather than specifying the methods to be used. If buyers demand concrete CO_2 reductions and allow the supplier to use suitable means, a positive effect will ensue. As a result of the above reasons, fuel savings cannot be forced via the pricing function. Buyers must demand concrete CO_2 reductions; otherwise the industry will most likely continue to lower prices, consequently creating ever-worsening conditions.

Driver Fuel Efficiency

"What is your current fuel consumption and what is the difference between that and a standard Good Practice driver performance?"

This is a small but effective step to increase awareness and generate large CO_2 reductions.