Managing Inbound Freight Costs

Inbound freight costs are generally hidden in your cost of goods but average 2% to 4% of revenue ranking it among the top eight operational expenses. While often overlooked, inbound freight management impacts gross margin, inventory control, purchasing staff productivity, receipt processing and fulfillment operations. To reduce the direct impact to the bottom line, consider these suggestions:

- **Review your "prepay and add" vendor invoices**. These occur when your vendor selects the carrier, prepays the freight, and adds the cost to your product invoice. Look for verification of actual costs (carrier's freight bill) and any additional handling fees. The industry average markup for handling is about 40%. Only allow prepay and add-freight terms when you can verify that your vendor ships at a lower rate than your negotiated carrier rates.
- **Establish a third-party consignee billing account** for vendors that ship small-package shipments (under 250 lbs.) to you via United Parcel Service or FedEx. By doing so you will be charged only the actual shipping costs rather than the additional handling charge by the vendor. You will also build a larger volume base upon which you can negotiate your overall UPS/FedEx rates.
- **Understand true freight costs and audit your actual paid-freight bills.** Research your actual costs. There are several reasons to do so: to verify actual freight-bill discounts from those stated in your tariff contract; to identify additional fees such as single-shipment charges or notification charges; to determine if you can negotiate FAK (freight all kinds) rates; to ensure that proper product classifications are being used rather than NOI ("not otherwise indicated"). By verifying actual freight bills you can determine if the carriers have given you "paper rates." Do not simply look at discount percentages. Understand the base rate, accessorial charges (if they apply) and FAK (freight all kinds) exceptions. Carrier's rates are also tied to product classification which is based on a combination of weight and density. For example, a bag of concrete mix has one of the lowest classifications, while comforters (bulky as they take up space but do not have weight or density) have one of the highest. FAKs allow a range of products to be billed at the lower end of the range. Apparel generally ranges from class 70 to class 100 and to have an FAK billed at class 70 can save 7% to 26% before overall discounts are applied. Compare pricing based on total actual cost for shipments.
- **Review your "free freight" terms** with frequently used vendors that offer them. Determine the average unit freight cost using your own carrier rates, shown as a percentage of product cost. Using this target percent, renegotiate "freight out" pricing with your vendors. If you can lower your unit cost, then freight is not "free."
- **Leverage LTL (less than truckload) Volume to Reduce Cost**. If you are using a number of carriers, select one or two regional carriers and one long haul carrier that can meet your needs and service requirements. Like small package advantages noted above, this will consolidate volume and provide additional leverage for rate negotiations. Also consider a buying consortium than can leverage the volume of hundreds of companies to provide lower rates.

- **Issue Vendor Routing Guides.** Keep it simple and to one page. It should include your requirements as to carrier selection, bill of lading instructions, required carton markings, contact info and a statement that penalties will be applied for non compliance. This can be one of the most important tools you can use to manage inbound freight. It should be part of your initial purchase order with every new supplier. They should be distributed to sales reps as well as the supplier shipping department. You should consider (if you do not already have one in place) a supplier compliance program where you outline all requirements of your suppliers including the routing guide. These performance guidelines should be monitored and enforced.
- **Manage with information tools** by maintaining a shipment database enabling you to track actual freight expense. Perform pre-payment audits of your freight bills to eliminate billing errors and the additional staff time to follow up on potential short pays and discrepancies and carrier phone calls. Establish a vendor scorecard to monitor compliance.

Managing inbound freight can have a dramatic impact directly to the bottom line. By implementing just a few of these suggestions, you can reduce your costs immediately to directly impact your profitability. Either manage it yourself or outsource it, but don't hesitate to act!

George Mollo is President of GJM Associates, Inc. Feel free to contact him for additional information and/or a free freight expense analysis at (845) 627-0788 or gjm1@gjmassoc.com. Visit his website at www.gjmassociates.com.