VPL

Downfalls of Traditional Pricing Models in Freight Management

Navigating the shift towards transparency and value

Pricing models in the third-party freight provider industry are complex and continuously evolving. This eBook serves as a guide for supply chain leaders to understand the nuances of traditional pricing models and their shortcomings.

To help the industry thrive amidst emerging market dynamics and customer needs, we advocate for a paradigm shift towards transparency, guaranteed savings, flexibility, data-driven decision-making, and a better customer experience.

Overview

Traditionally, comparing various freight pricing models was straightforward enough. Each model primarily relied on discounts on the provider's carrier list for differentiation.

However, with the emergence of more sophisticated pricing models, it's harder than ever to decipher the most competitive pricing based on carrier discounts alone.

Given the difficulties of switching providers once a contract is in place, choosing the best freight provider in today's landscape requires a deeper analysis to ensure health systems stay competitive.

GAIN SHARE

Under the gain share pricing model, freight management providers receive a percentage of the savings they source for their clients. In other words, providers are incentivized to achieve maximum savings for their clients to ensure maximum value of their compensation.

Implications for the health system

On the surface, the gain share model is attractive given its implication of no up-front costs: the health system seemingly only pays if the provider delivers savings.

However, the downfall of the gain share model comes from the fact that freight providers project these savings by re-pricing the health system's existing shipments under their own pre-negotiated rates with a single carrier. Then, these figures are presented as potential savings at the shipment level. They are projecting potential savings if the stars perfectly align.

How the freight provider makes money

This arrangement serves as a lucrative profit center for the freight provider. They negotiate a pre-determined gain share percentage with each customer, which ranges from anywhere between **15% to 50%.**

At the end of each month, the freight provider then calculates the savings for every shipment compared to what it was on the health system's incumbent freight program.

Subsequently, the freight management provider delivers an invoice for the average savings per package multiplied by the pre-negotiated gain share amount.

Where the gain share model falls short

The projected savings value under a gain share pricing model assumes that all shipments can be converted to their program.

The model breaks down if the freight management provider fails to convert all shipments to their pre-negotiated single-carrier price.

As a result, unconverted shipments or shipments made outside of the program end up costing the health system significantly more than before.

Example

A health system adopts a new gain share freight program on which they can manage 70% of their shipments. Once this change is initiated, the previous freight program begins to charge the remaining 30% of shipments under it's "disengagement tier" pricing, resulting in significant cost increases by as much as double their previous rate.

Consequently, while the health system may save money on 70% of its shipments, the doubled costs on the remaining 30% not only negate these potential savings but may even lead to higher overall expenses than before, offsetting any financial benefits claimed by the freight management provider.

It's common for health systems to realize this only after their initial deployment with the freight management provider, prompting them to terminate the program shortly thereafter.

How health systems can respond

Health systems can mitigate the risk of a shortfall on expected savings by:

1. Discounting their projected savings by 20-30%, recognizing the actual savings will likely not be as substantial as initially claimed.
2. Asking for data from the freight provider's previous two or three implementations and paying particular attention to how quickly it achieved shipment conversion relative to the proposed plan.
3. Holding freight providers accountable by demanding a contractual guarantee for savings, irrespective of the volume converted.

HIDDEN MARGIN

Under the hidden margin model, freight management providers consolidate their customers' shipping spend into a single account. From here, they can negotiate more favorable discounts with carriers and pass a portion of these savings on to the health system.

Implications for the health system

The hidden margin model presents various challenges for health systems that can be difficult to pinpoint, leading to its characterization as the *hidden* margin model.

Under this model, health systems are typically provided with a single account number that grants them access to volume-discounted rates. Upon its conception more than twenty years ago, this program was promising because volume discounting does bring overall costs down.

However, freight providers operating on the hidden margin model often go to great lengths to hide their true profit margins from their customers, competitors, and even the carriers themselves, creating transparency, quality, and cost issues.

How the freight provider makes money

By leveraging increased shipping volume, freight providers can successfully negotiate significant discounts with carriers. However, the provider typically only passes a modest portion of these savings on to customers and retains the rest as profit.

Under the hidden margin model, freight providers charge a percentage of the total shipping cost. As a result, not only do providers profit from shipping discounts, but with a percentage rate they also earn profit on everything from annual carrier rate increases to inflation to service-level choices like express shipments.

Where the hidden margin model falls short

The hidden margin model lacks visibility into the actual costs of services provided by the freight manager. On the invoice, it appears that 100% of the charge is allocated back to the carrier for handling the delivery.

Because this model charges customers an additional percentage fee for each shipment, which fluctuates and remains unpredictable, they have no incentive to optimize service levels as this ultimately means less profitability for them.

Example

Consider express shipments under the hidden margin model. If express shipments under a given contract cost three times as much as standard shipments, freight providers will then reap three times the profit on every express shipment.

Since the freight provider calculates shipping costs as a percentage of the underlying carrier costs, a 30% markup on a $50 express shipment is much more lucrative for them than a 30% markup on a $15 ground charge.

Consequently, resellers have little financial incentive to offer transparency or actively assist their customers in finding lower-cost alternatives, and at times may even make undisclosed service markups. This ends up being considerably more costly for the health system.

The hidden margin model has been the standard practice for many years, primarily due to a lack of any viable alternatives. However, recent advancements in freight management pricing models are prompting a reassessment of its value in a rapidly evolving landscape.

How health systems can respond

Health systems can mitigate the risk of a shortfall on expected savings by:

1. Demanding visibility into margins at each service level to determine a more accurate freight management service spend.
2. Advocating for an incremental savings guarantee, including an outline of the necessary KPI's and data to track its progress.

FEE-FOR-SERVICE

VPL's fee-for-service model is as simple as it sounds. We apply a transparent, consistent program fee to each inbound and outbound shipment that we manage.

Benefits of the VPL fee-for-service model

We contractually guarantee savings to remain accountable and eliminate your financial risk. If VPL can't deliver on our savings guarantee, we cut you a check for the difference.

This model creates a new system of incentives wherein our team is highly motivated to increase your access to suppliers and volume, and why we can contractually guarantee results.

This pricing model is a cornerstone of our partnership philosophy. Combined with our foundation of technology and elevated customer service experience, we empower you to take control of your supply chain, optimize shipping processes, and drive continuous improvement.

How our model benefits health systems

Choice and Control

VPL offers the only carrier-agnostic freight management solution available in the industry to grant you total choice and control over your shipping operations.

Unlike other providers that limit their customers to a single carrier, VPL offers comprehensive access to FedEx, UPS, USPS, and couriers.

This approach offers several advantages:

- **More savings:** Accommodating multiple carriers on a single platform allows us to onboard more suppliers and volume onto our program, improving efficiency and ultimately increasing savings.
- **Flexibility between carriers:** VPL can seamlessly pivot shipping workflows between carriers to mitigate disruption risks and ensure uninterrupted service.
- **Negotiation power:** If your health system or GPO negotiates better rates with one carrier over another, VPL can flip your suppliers at any time, maximizing your cost savings potential.

Visibility and Resilience

We understand the critical importance of visibility into the whereabouts and arrival times of each shipment. As such, we empower you with the technology to make informed decisions and adapt quickly to changing circumstances.

Our platform grants real-time visibility into shipping movement to support supply chain resilience:

- **Track-and-trace:** Monitor precisely when and where vital product will arrive within the health system to enhance operational efficiency and peace of mind.
- **Proactive notifications:** Receive automated tracking updates for any shipment for contingency planning in the event of delays.
- **Dock and space planning:** Advanced notice of shipping volume by location helps you effectively staff the dock and plan for space to run smoothly.

Actionable Insights

VPL's comprehensive analytics platform provides visibility into itemized carrier costs and performance data, allowing you to uncover more cost savings and drive initiatives for improvement.

We grant you 24/7 access to your data, and our dedicated customer success team will identify cost savings opportunities and monitor supplier compliance to keep you ahead of the curve.

Four tailored dashboards offer a strategic starting point for cost savings and resiliency initiatives with us:

1. **Inbound Freight Analytics:** Track trends in service level mix to identify cost-saving opportunities by adjusting supplier shipping and ordering behaviors.
2. **Outbound Shipping Insights:** Monitor total spend, shipment volumes, and average cost per shipment by provider and location, including trends in service level preferences.
3. **Supplier Governance:** Review spending breakdowns by supplier to show managed and unmanaged volumes and trend managed spend over time. Plus, identify compliance issues and drive informed conversations to change behavior.
4. **Supplier & Carrier Performance Metrics:** Monitor lead times by supplier based on purchase order request dates and carrier lead times. Review carrier performance metrics and assess late shipments by recipient location.

Exceptional Customer Experience

Through our C.A.R.E. program (Continuous Assessment and Recommendations for Excellence), we serve as your proactive business partner. By focusing on shared goals, high-touch support, and full transparency, our team is accountable to exceptional value and service.

Our commitment to excellence is reflected in three key principles:

1. **Shared Goals:** We take a collaborative approach to align on your strategic initiatives and track progress toward mutual objectives.
2. **Proactive Support:** Our guided business reviews identify opportunities for improvement, offer quick wins, and help you strategize for long-term success.
3. **Transparency:** You have transparent, anytime access to your data, including insights on performance against other industry leaders, progress updates, and target improvement areas.

Closing Thoughts

Traditional freight management pricing models pose a number of challenges, from the potential pitfalls of the gain share model's unconverted shipments to the lack of transparency and higher costs associated with the hidden margin model.

VPL's fee-for-service model stands out as a beacon of transparency and value with our simple program fee and contractually guaranteed savings. VPL empowers health systems with choice, control, and flexibility with real-time tracking, proactive notifications, comprehensive analytics, and dedicated customer support.

In navigating the complexities of the freight management landscape, embracing transparency, accountability, and value-driven partnerships is imperative, and VPL's fee-for-service model embodies these principles and more, offering a transformative solution for health systems to optimize shipping processes and drive continuous improvement.

More of a visual learner? Check out our animated videos that break down each of these pricing models.

Let's take a look

Modern clinical supply chains for healthier patients.

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