

TRUCKLOAD FUEL SURCHARGES EXPLAINED

GAIN VISIBILITY AND REDUCE COSTS BY MODERNIZING YOUR **FUEL SPEND**



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FROM INSIGHT SOURCING GROUP

INTRODUCTION

Fuel spend in truckload can make up as much as 20-30% of a shipper’s total transportation spend. Most companies believe this is managed and under control because they use some type of fuel program that adjusts with market price. However, this spend is being overlooked and is an untapped area to drive improvement. In a continuously evolving market, many companies are still using traditional fuel schedules that are out of date.

Not only does this lead to over-reimbursing on fuel, it also obscures the entirety of your truckload spend through an inorganic transfer of fuel costs to linehaul. This transfer ultimately makes it difficult to analyze your own network, benchmark with industry, and understand your supplier’s cost structure. For these reasons, among others, modernizing your fuel spend is a strategic step in harnessing your network.

FUEL SCALES: WHY DO WE HAVE THEM AND HOW ARE THEY SET UP?

When transportation was fully deregulated in July 1980, companies were looking for a way to fairly share the burden of fuel costs. A gallon of diesel cost \$1.11 at the time, and it’s no coincidence that this is around the base(peg) for most company’s fuel surcharge programs.

A typical truckload fuel surcharge program is made of four primary components: the base (or peg), the escalator (or MPG), the increment, and an index that they tie to. Below is an example and definitions of the four primary components:

Index:	<i>DOE National Average - U.S. No 2 Diesel Retail Prices</i>	
FSC Base:	<i>\$1.10</i>	<i>\$USD per gallon</i>
Index Escalator:	<i>\$0.05</i>	<i>\$USD</i>
FSC Increment:	<i>\$0.01</i>	<i>\$USD</i>

Base/Peg – This is the starting point for your fuel scale, below which there is no additional payout for fuel. It is tied to a named index like the DOE. While some scales do allow for shipper reimbursement when fuel drops below the base, this is uncommon unless you have a high peg, and it can make for difficult accounting.

Escalator/MPG – This is the amount fuel price must increase by over the base to trigger higher payouts. A \$.05 escalator is very common, meaning for every \$.05 over the base fuel price you must reimburse the carrier according to your increment (usually \$.01). If fuel prices are \$2.00 more than your base you would be paying \$.40/mi to your carriers.

This escalator is also a proxy for the miles per gallon (MPG) carriers are getting with their tractors. Below is a chart demonstrating this effect for a sample 214-mile shipment from Atlanta, GA, to Knoxville, TN.

Atlanta, GA to Knoxville, TN, 214 Miles, DOE Diesel Price: \$2.40

Miles	214	214	Miles
MPG/Escalator	5	5	MPG/Escalator
Gallons	42.8	\$1.10	Base
\$/Gallon (DOE - \$1.10 Base)	\$1.30	\$0.26	Payout/mi (DOE - \$1.10 Base)/Escalator
Total Cost (\$/Gallon X Gallons)	\$55.64	\$55.64	Total Cost (Payout/mi X Miles)

Increment – This is the amount you increase your fuel payout for each amount your escalator is higher than the base. For most truckload fuel tables this is \$.01, but some carriers may list it as a percentage of linehaul. Percentage indexes are more common in intermodal or less-than-truckload scales.

Index – This is the published reference that guides the fuel program. Most fuel programs today are updated on a weekly basis and reference a DOE national or regional average for diesel retail prices. This is the most common index for truckload and less-than-truckload surcharge tables.

IMPROVING VISIBILITY AND REDUCING FUEL SPEND

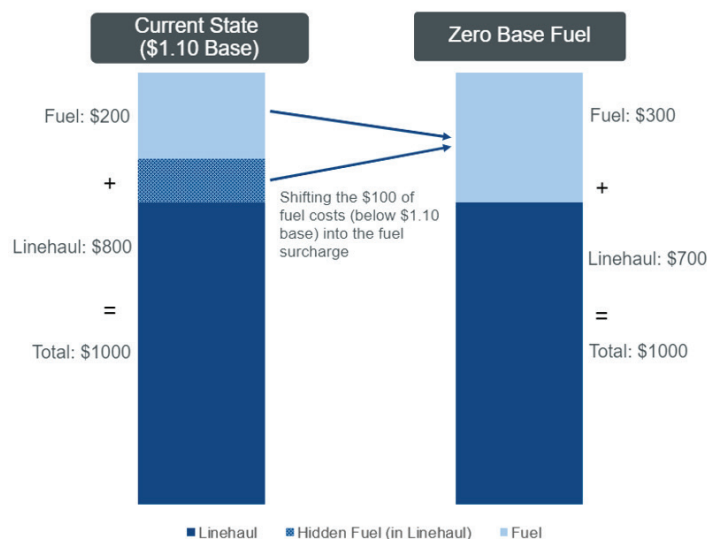
The same components that make up a traditional fuel scale are the levers shippers can use to adjust their programs to improve cost clarity and drive improvements in fuel spend. Three recommended levers to tackle this topic are: shifting from your existing base/peg to a zero-base program, increasing escalators/mpg to modern fuel standards, and leveraging index models that better represent actual purchase price on a lane by lane basis. Below are the details on those three changes.

☑ Shifting to Zero-Base.

Many companies are still using \$.05 (5 mpg) escalators with a \$1.10 base, meaning that there is roughly \$0.22 / mile that is not represented in fuel reimbursements to carriers. This \$0.22 / mile is not simply vanishing, but rather is being shifted into your linehaul, which obscures the true split of operating costs.

Shifting to a zero-base scale is the quickest way to increase transparency into the breakout of your spend. The zero-base change is a net-neutral dollar-for-dollar swap of the hidden fuel baked into your linehaul to its appropriate cost center of fuel.

To determine the amount of spend that needs to shift from linehaul to fuel, divide your base by your escalator and make that relevant shift on a per-mile basis. You can make this change at any point, even outside of an RFP. Because it is an even swap there is no change to total reimbursement to the carriers.



A shipment with \$800 linehaul and \$200 fuel in the past may now be \$700 in linehaul and \$300 in fuel. It's important to note while this does better reflect actual costs, your fuel spend will go UP and linehaul will correspondingly go DOWN by the same amount. So be prepared with clear information to present to your finance teams internally.

✓ **Increasing the Escalator.**

Increasing your escalator is the easiest way to recognize a reduction in fuel costs and properly align with the true fuel efficiency of today's equipment. According to the North American Council for Freight Efficiency (NACFE) today all Class 8 trucks get an average of nearly 6 MPG with advanced carriers reaching over 7.2mpg and best-in-class carriers running 2019 or newer equipment nearing 10 mpg. This means with a 5 mpg/5 cent escalator you are actually reimbursing carriers based off a model that no longer matches their modern efficiencies. This fuel change is best done during an RFP to allow carriers to adjust to the new reduced fuel payouts.

✓ **Using Wholesale Fuel Program Service/Index.**

In reality, carriers are not buying fuel at the prices you see advertised along the highway. They have negotiated discounts directly with the retailers that are between \$.30 to \$1.00 per gallon lower than DOE retail. The DOE Retail Index only reflects the advertised price, not the average of the negotiated purchase price. It becomes very difficult to know if carriers are passing this savings on to you. There exists a limited base of third-party services that can also help lift this veil and get down to lane-level wholesale/negotiated diesel prices to remove all the final sources of fuel price distortion and bring the ultimate level of visibility and transparency to all parties. This change is also best done during an RFP to allow carriers to make appropriate adjustments.

CONCLUSION AND KEY TAKEAWAY

Fuel programs have remained mostly unchanged and ignored since their inception and regarded as industry norm. However, these are large buckets of spend and should not be ignored.

ISG has led clients through institution of standardized fuel programs, conversion to zero-base, and increases to escalators/mpg. These changes can bring modernization and full visibility to an accurate breakout of your transportation costs. While each of these levers can be worked individually, when coupled together appropriately they can drive exponential reductions in fuel spend, totaling 5-10%, or even more, of total transportation costs.

For example, ISG recently drove more than 15% savings through competitive sourcing, fuel program, and mode optimization for a large national truckload shipper. The client was able to capture the full expected reduction in fuel along with significant additional savings in linehaul and a strategic RFP configuration.

Insight Sourcing Group has had tremendous recent success partnering with organizations to execute on the cost optimization approaches described above, in many cases driving savings in excess of the ranges outlined above and delivering a strong ROI. If you are interested in learning more or looking for a partner with the capability and expertise to execute on the approach to drayage described above, please contact Dylan Alperin at dalperin@insightsourcing.com or (770) 769-5011.

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ABOUT INSIGHT SOURCING GROUP

Insight Sourcing Group is the leading consulting firm in North America focused exclusively on strategic sourcing and procurement-related services. Founded in 2002, the firm works with senior executives and procurement leaders to accelerate strategic sourcing savings, increase spend visibility, provide ongoing category analytics for savings tracking, and implement procurement best practices. Insight Sourcing Group has worked with hundreds of corporate clients of all sizes and over 50 private equity firms.

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