Fleet Outsourcing

Evaluation Guide

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Introduction:
Objectives of this Guide

Fleet outsourcing, or dedicated contract carriage, is a trucking option that is used by many successful Canadian companies across a number of industries. This model is used by large companies as well as hundreds of small and medium-size firms. Regardless of the company size, they use a dedicated fleet outsourcing model to maintain the control of having their own dedicated trucks and drivers, without the headaches, capital cost burdens, and liability of operating their own fleet.

But is fleet outsourcing the right decision for your company? What factors should you consider in determining the best fleet model to support your strategic and growth objectives?

This guide is intended to be an objective resource that lays out both the pros and cons of private fleet ownership versus dedicated fleet outsourcing. While Canada Cartage is the author of this paper and provides fleet outsourcing services, we do not believe that it is the right solution in all situations. Our goal is to help you objectively evaluate if it makes sense for your company.

Background:

Defining "Private Fleets" vs. "Dedicated Outsourced Fleets"

THE PRIVATE FLEET MODEL

The private fleet model is typically deployed by companies who wish to maintain 100% control over the distribution and final delivery of their products. It is often used in industries with a high level of service interaction with customers, such as inside deliveries into retail outlets.

Private fleets are typically used for "outbound" freight (freight being delivered from a distribution centre or manufacturing location to a retail store, end-customer or end-user) versus "inbound" freight (freight coming into a distribution centre or manufacturing facility from suppliers).

Private fleets are often employed when deliveries are in a highly dense area, typically within 200 kilometers of origin, and for daily runs with five or more stops per day. Vehicles will often start and end their day from the same location.

In the private fleet model, business owners:

- acquire and maintain the equipment (either through purchase, lease, or rental arrangements);
- recruit, screen, hire, train, and manage the drivers;
- meet and maintain all applicable regulatory and safety requirements of provincial or federal transportation authorities;
- assume all insurance, risk, and liability for the operation of their fleet; and,
- dispatch and route daily shipments to customers.

THE OUTSOURCED DEDICATED FLEET MODEL

For companies with the same private fleet service requirements as above, but who do not want to operate their own fleet, an outsourced dedicated fleet is the alternative model. In this scenario, companies hire a third-party dedicated fleet provider who typically supplies:

- tractors and trailers that are custom specified to the customer's needs; the equipment is 100% dedicated to the customer's account, and not shared with other customers;
- drivers who are trained and dedicated solely to the customer's account;
- equipment and uniforms that are branded to promote the customer's business;
- additional "on-demand" equipment to cover volume surges during seasonal peaks;
- on-going maintenance of equipment;
- emergency service for repairs and replacement equipment to reduce truck downtime;
- insurance coverage and assumption of liability for the equipment;
- dispatch and routing of shipments; and
- Key Performance Indicators (KPIs) and on-time delivery reporting.

Equipment is usually domiciled at the shipper's location, rather than at a trucking terminal, and dedicated drivers start and finish their day from the shipper's facility.

Please note that not all outsourced fleet providers can supply all of the features listed above.

THE HYBRID MODEL: PRIVATE FLEET & OUTSOURCED DEDICATED FLEET

Especially true for large organizations with complex supply chain requirements, logistics managers will often develop a hybrid model. This model may combine a private fleet with an outsourced dedicated fleet, as well as the use of freight brokerage services, and 3rd parties that can provide capacity for volume surges.

Some firms choose to use their private fleet to serve core customers while using "for-hire" less-than-truckload (LTL) and truckload (TL) carriers for added capacity or shipment density.

The Private Fleet Model:
Advantages & Disadvantages

There are both pros and cons to operating a private fleet. The following are some of the primary benefits and drawbacks of fleet ownership:

ADVANTAGES OF PRIVATE FLEETS

1. **Control:** For many companies, control is the main driver for investing in a private fleet. The ability to have capacity on demand (versus using LTL or TL carriers), accommodate short response times, and have specially-tailored equipment types to match commodities are all compelling reasons to build a private fleet versus using a for-hire carrier.

> "The impetus to starting a private fleet is due to corporations wanting the control they cannot get from for-hire fleets."
>
> David Cullen
> "*Rethinking the Private Fleet*"

2. **Multi-tasked Drivers:** For some companies, fleet drivers wear multiple hats. They routinely interact with shipping and receiving personnel both within their firm and their customers' operations. "They gain a thorough understanding of their customers' operations and can improve customer service by streamlining the pick-up and delivery process, establishing a rapport with customer personnel, and anticipating customer requirements." (Farris, Theodore M. & Pohlen, Terrace L., 2008). For some organizations, the driver can even become an extension of the sales force and may be utilized to promote new services or products.

3. **Guaranteed Capacity:** Compared to using a for-hire LTL or TL carrier, owning private fleet guarantees capacity availability. This is especially true during periods of high freight volumes, when carrier capacity is tight and freight rates rise. A private fleet helps ensure that goods continue to flow cost-effectively.

4. **Marketing:** The advertising space on the sides of trucks provides a marketing opportunity, with trucks serving as rolling billboards. The advertising may provide significant value to the firm, especially if the truck has a clean appearance and is operated safely.

5. **Negotiation Leverage:** A private fleet can provide leverage when shippers are negotiating

with for-hire carriers. Freight moving on the private fleet represents lost revenue to the for-hire carrier. The private fleet preserves the option to divert freight from for-hire carriers if rates become too high or service declines. Some firms maintain a small private fleet to preserve an in-house competency to effectively negotiate with carriers or to expand their transportation operations if the need should arise in the future. (Farris, Theodore M. & Pohlen, Terrace L., 2008).

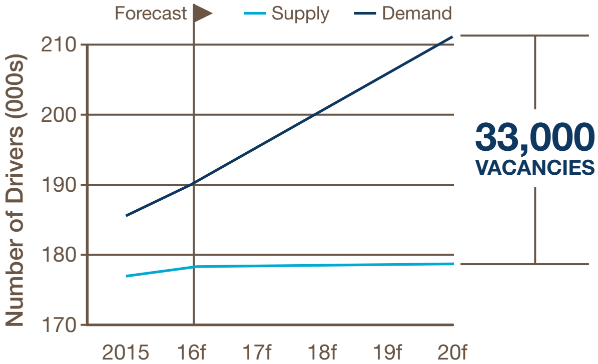
6. **Avoidance of Fees from For-Hire Carriers:** By running their own fleets, companies eliminate the costs associated with for-hire carriers' service fees and their need to make a profit from operations.

DISADVANTAGES OF PRIVATE FLEETS

While there are many advantages to operating a private fleet, there are also disadvantages. Some of the major drawbacks include:

1. **Driver Shortage:** A shortage of drivers has increased the costs of hiring, training, and retaining drivers (Gallagher, 2007). Based on industry data collected by Statistics Canada and The Conference Board of Canada, it has been forecasted that by 2020, the gap between the supply and demand of drivers could be over 33,000 vacancies. At best, private fleets will need to increase their spend on advertising, recruiting, road testing, and background checking verifications to keep drivers in the seat. At worst, private fleets will have idle trucks and missed deliveries due to this lack of drivers.

For-Hire Trucking Industry Driver Supply and Demand Gap, Canada



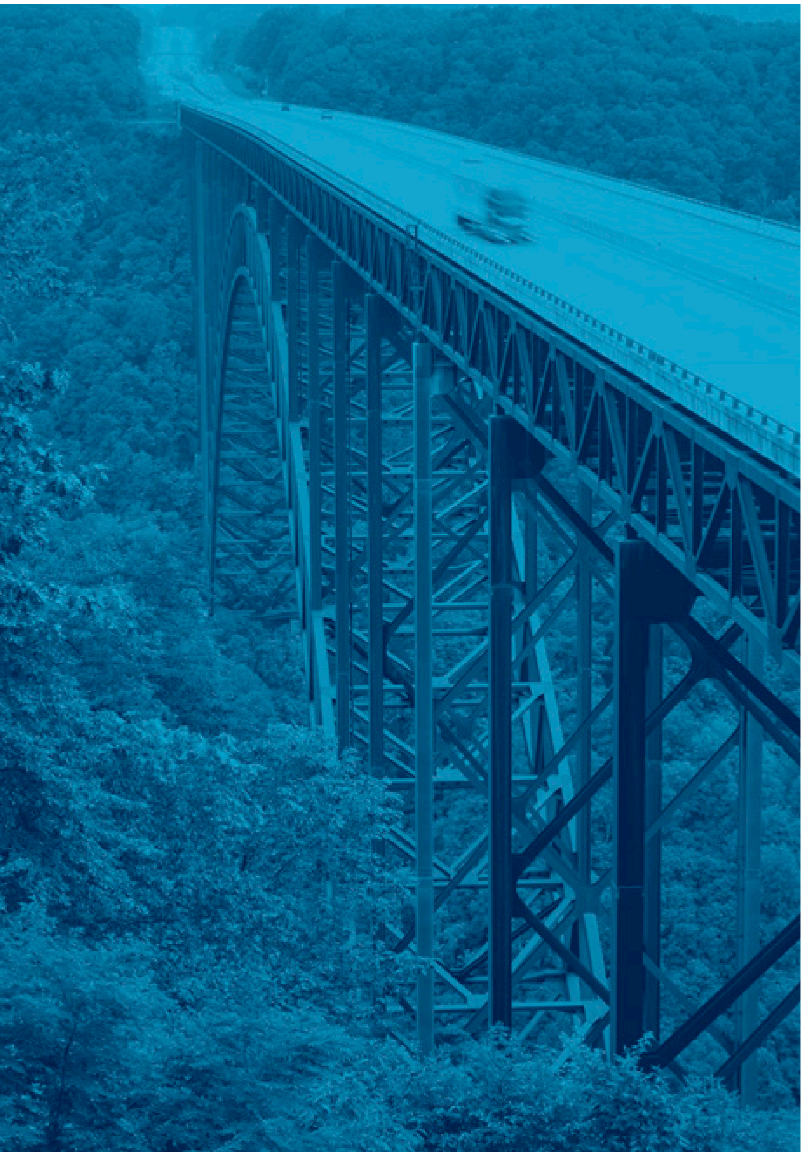
f = forecast
Source: The Conference Board of Canada

2. **Regulatory Changes:** Private fleet operators must meet and maintain provincial and/or federal regulations dictating the safe operation of their fleet. This includes:
   - commercial vehicle and fleet registration, testing, and reporting;
   - driver and vehicle licensing;
   - safety programs, record-keeping, and driver files;
   - preventative maintenance, record-keeping, and vehicle files;
   - understanding, monitoring, and documenting driver hours-of-service rules;
   - complying with dangerous goods regulations, where applicable;
   - cargo securement regulations and monitoring of safe practices; and,
   - understanding vehicle weight and dimension regulations and restrictions. Seasonal restrictions on certain roads needs to be monitored and enforced with the private fleet, as well as weight limits, and types of equipment that can be driven on certain roads.

3. **Underutilization Costs:** Most companies experience shipping peaks and valleys – busy days during the week, busy weeks during the month, or seasonal volume spikes. Many private fleets have scaled their equipment needs to handle peak periods and satisfy customer demands. However, this can result in equipment sitting idle during slow periods. Furthermore, many private fleets have an imbalance of outbound and inbound movements, resulting in empty backhauls that can significantly increase transportation costs.

4. **Labour Management:** The private fleet employer must manage all aspects of driver labour management. This includes:
   - recruiting, screening, road-testing, hiring, training and on-going management of drivers;
   - wages, benefits, and payroll administration;
   - pension administration;

- monitoring of hours of service and applicable provincial or federal overtime rules;



- on-going safety training and compliance;
- worker compensation insurance claims;
- back-to-work programs, discipline, and termination; and,
- where applicable, labour management may also include union contract negotiations and management attention, arbitration costs, union grievance costs, legal fees, and on-going maintenance of the management-union relationship.

Due to the specialized nature of truck driving and employment regulations, the above tasks often fall outside of the normal labour management administration for other types of employees. This results in specialization in handling driver employment issues, which drives up internal administrative costs.

5. **Diversion of Capital Away From Growth:** Fleet equipment and facilities require a significant investment of capital. Since capital is generally a scarce commodity for most companies, it should be invested where the firm can create the highest return for investors. Management must carefully assess whether the private fleet provides sufficient savings to warrant the investment. Financial measures such as return on assets or economic value added (EVA) tend to make private fleets unattractive unless capacity is fully utilized and substantial savings are obtained.

> "Companies financing their fleet with cash often do not incorporate the opportunity cost of capital into their purchasing decision process, thus undersestimating the total cost of ownership."
>
> Stella, Singh, & Immordino, 2013
> *"Own or lease: are you making the right choice for your truck fleet?"*

6. **Risk and Liability:** Many companies underestimate the enormous exposure that is part of running a fleet of trucks on busy highways and through city streets. While insurance can mitigate this risk, firms typically lack the buying power to purchase economical premiums, resulting in high fees and deductibles. Firms must also pay for legal fees when defending against legal actions or appeals. Fleets with high accident rates or safety infractions will experience another disadvantage: provincial inspection stations will require vehicles from fleets with unsafe records to stop more frequently for inspections. These stops extend transit times, increase variability, and reduce driver and equipment utilization.

7. **Equipment Procurement & Buying Power:** When acquiring new equipment, private fleet operators must:
   - create specifications for the proper tractors, trailers, and specialty equipment needed (i.e. hauling weight capacity, power tail gates, trailer-mounted forklifts, etc.);
   - negotiate with equipment manufacturers, dealers and finance companies to acquire equipment; and,

- factor in the right amount of equipment to buy, as well as the right mix of properly specified tractors and trailers to meet seasonal needs, without having excess equipment during slower periods.

The steps above require time, expertise, and management attention. In some cases, companies acquire the wrong equipment for specialized commodities (eg. too much or too little horsepower, oversized or undersized trailers, etc.), due to lack of experience. Smaller fleets also lack the buying power that larger fleet providers have for equipment, maintenance/repairs, parts, and fuel spend.

8. **Non-core Distraction for Management:** Management attention may be diverted from important strategic matters while managing issues related to fleet management. Administrative staff and costs often expand to keep pace with requirements for driver recruiting and retention, safety training, hazardous materials processing and reporting, hours of service compliance, permits and licensing, provincial and federal ministry of transportation reporting, accident investigations, insurance, claims for for-hire services, payroll and benefits, and supervision.

9. **Lack of Visibility of 'Total Cost of Ownership':** The challenge for private fleet operators when assessing the financial viability of their fleet is determining the "TCO" – Total Cost of Ownership. Many of the disadvantages of fleet ownership listed in items 1 – 8 above are difficult to quantify. Accounting systems frequently "bury" the indirect costs associated with private fleet management, and do not provide the visibility needed to effectively manage the total costs associated with a private fleet.

> "Trucking fleet managers have historically not considered detailed total cost of ownership benchmarks to measure fleet management and cost effectiveness and efficiency."

Stella, Singh, & Immordino, 2013
"Own or lease: are you making the right choice for your truck fleet?"

The Fleet Outsourcing Model:
Advantages & Disadvantages

For most companies, the decision to acquire and operate a private fleet was made because management was evaluating the pros and cons of an insourced fleet versus using a for-hire common carrier (either an LTL or TL carrier).

However, fleet outsourcing, or dedicated contract carriage, is a transportation option that is designed to provide companies with the benefits of private fleet ownership, but frees them from the distraction of running their own trucking company. In fact, many of the "Advantages" of private fleet ownership detailed earlier in this guide also apply to the outsourced fleet model.

ADVANTAGES OF FLEET OUTSOURCING

1. **Customer Service:** Fleet outsourcing service providers partner with their customers by providing trucks and drivers who are 100% dedicated to their account. Some suppliers, such as Canada Cartage, may hire the existing roster of drivers when they transition a fleet from private ownership to an outsourced arrangement. Similar to a private fleet, outsourced fleet drivers have consistent routes and stops, and get to know customers on a personal level. As part of the implementation process, the companies develop a mutually-agreed-upon Service Level Agreement (SLA), customized driver training specific to the account, and Key Performance Indicators and metrics to track on-going performance.

> "Many companies find that service levels measurably improve after a private fleet conversion…as does the company's bottom line."
>
> Clifford Lynch
> *"Why Shippers Can't Afford NOT to Convert Their Private Fleets"*

2. **Control:** Control over the delivery process is often cited as one of the top three reasons why companies decide to run a private fleet as opposed to using a common carrier. However, with a dedicated outsourced fleet, companies can maintain the same level of control over their fleet and the delivery process, without the cost, hassle, and risk of owning and directly managing it. The equipment and drivers are at their disposal, and routing and emergency deliveries can be made with very little notice.

3. **Cost:** Experienced outsourced fleet providers can drive down fleet operation costs in a number of areas. These include:

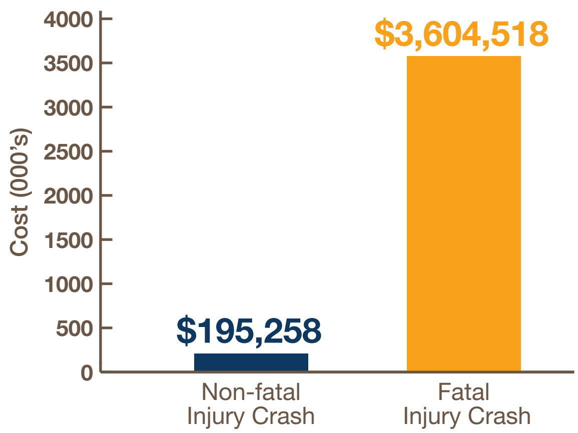
    - better utilization of equipment; fleets are scaled to optimal volume levels, and extra equipment is deployed to the account only during peak periods;
    - lower equipment acquisition costs and fuel costs due to greater buying power;
    - lower administrative costs within the customer's organization in areas of recruiting, hiring, training, driver management, routing, dispatch and regulatory management; and,
    - route optimization and re-engineering to reduce kilometers driven and labour costs.

4. **Management Focus on Growth, Not Trucks:** Fleet outsourcing provides the benefits of a private fleet, but without the distractions, management involvement, and investment of energy to meet changing industry and regulatory demands. These distractions will increase as driver shortages become more acute, and transportation regulations grow in complexity. While fleet outsourcing does not solve these issues, it does shift the burden of finding solutions to the outsourced fleet provider.

5. **Capital Diverted to Growth, Not Trucks:** Most businesses have restraints on their available capital for growth and expansion. Diverting this capital to purchase trucks for a private fleet is only advisable if the private fleet generates more savings than the potential returns that could be gained if the capital went into growth investments such as new production equipment, upgraded facilities, or technology. Fleet outsourcing preserves capital, while providing the same (or better) savings gained from a private fleet.

6. **Risk and Liability:** An area that is often overlooked for private fleet operators is the significant risk and liability that the business is carrying by running its own trucks. According to a 2006 study by the U.S. Federal Motor Carrier Safety Administration, the cost to a company for a non-fatal injury crash averaged $195,258. As expected, fatal crashes cost more than any other crashes. The average cost of fatal crashes was $3,604,518 per crash. The cost estimates exclude mental health care costs for crash victims, cargo delays and earnings lost by family and friends caring for the injured. And, those figures do not fully account for insurance premium hikes, legal fees, loss of business (from negative public relations), and other potential fallouts. "Businesses must face the fact that one major accident could spell financial ruin. Why not transfer that burden to a major carrier with the means to bear it." (Lynch, Clifford, 2007).

Private Fleet Accident Costs Per Incident



Source: FMCSA Study - Unit Costs of Medium and Heavy Truck Crashes, Federal Motor Carrier Safety Administration, December 2006.

> "The costs per non-fatal injury crash averaged $ 195,258. As expected, fatal crashes cost more than any other crashes. The average cost of fatal crashes was $ 3,604,518 per crash."

Zaloshnja, Eduard, Ph.D. & Ted Miller, PH. D, 2006. *"FMCSA Study - Unit Costs of Medium and Heavy Truck Crashes".*

7. **Cost Certainty and Visibility:** A 2013 study conducted by Ernst & Young concluded that many companies do not have a strong sense of their truck fleet total cost of ownership, and actually have systematic biases when evaluating fleet options. Many administrative costs are invisible on the P&L, and spread across multiple departments including logistics, customer service, human resources, procurement, finance and tax, and the executive team. Fleet outsourcing provides complete visibility into the costs of transportation for dedicated fleet moves, and billing models can provide greater cost certainty and more accurate forecasting.

8. **Branding:** Because equipment is 100% dedicated to a customer in the fleet outsourcing model, tractors and trailers can be branded with company logos and colours. Drivers can also wear customer uniforms, further reinforcing the brand and making the outsourced fleet almost indistinguishable from an insourced fleet in the eyes of the end-customer.

DISADVANTAGES OF FLEET OUTSOURCING

1. **Control:** While fleet outsourcing provides dedicated drivers and trucks to shippers, and a far greater level of control than using a for-hire common carrier, there is still less control for the shipper as compared to running a private fleet. Shippers need to determine what level of control is needed, and whether fleet outsourcing can meet that standard.

2. **Fleet Provider Management Fees:** Fleet outsourcing providers will charge a fee for their services which do not exist in the cost model for private fleet operators. On a direct cost basis for items such as labour, fuel, equipment, and maintenance, there will be some benefits gained by fleet outsourcing, but these could be cancelled out by the profit margin charged by the fleet outsourcing provider. Ultimately, firms need to gain visibility into their current "Total Cost of Ownership" before comparing to the costs of an outsourced dedicated fleet provider.

3. **Implementation Risk:** Divesting a private fleet of trucks and shifting the employment of drivers to an outsourced provider requires management time and attention to ensure a successful implementation. Companies should assess the outsourced providers resources, experience, and track record of successfully managing similar fleet management implementations.

4. **Outsourced Service Provider Risk:** Selecting the right partner also carries risk. As private fleet operators assess their choices of outsourced fleet service providers, they should ask questions and evaluate competitors around the following areas:

   - Are they a well-established, financially viable company?
   - Can they demonstrate leading-edge recruiting, retention, training, and safety processes and procedures to ensure you have best-in-class drivers and a safe fleet?
   - Do they use company drivers, owner-operators, or both?
   - Are they well-capitalized, and able to acquire new equipment to meet your fleet requirements now and in the future?
   - Do they utilize on-board technology, and can they provide metrics and KPIs to help you measure costs, productivity, and customer satisfaction?
   - If needed, can they provide national service delivery coverage and local facilities and management?

Next Steps:

The Decision-making Process for Private Fleet vs. Fleet Outsourcing

Since there is no "right" answer to the question of whether to insource or outsource your fleet, w e recommend that organizations should consider using a decision-making framework consisting of the following steps to fully evaluate their fleet options:

STEP 1
Project Objectives

Document the objectives of the project. What are the key drivers that are causing you to consider fleet outsourcing? Which factors are more important than others? To assist you with this phase, Canada Cartage can provide you with a project management template specific to fleet outsourcing considerations. Contact your Canada Cartage representative, or email us at info@canadacartage.com.

STEP 2
Assess Current Proficiency With Fleet Management

In important areas of professional fleet management, you should assess your organization's current levels of proficiency. This will help you to focus on where you want to gain improvements, and which areas are the most important to your company. To assist you, Canada Cartage has created a "Fleet Management Self-Assessment Guide" that covers twenty-four important areas of fleet management. You can download the guide at www.canadacartage.com/selfassessmentguide.

STEP 3
Determine Total Cost of Ownership (TCO)

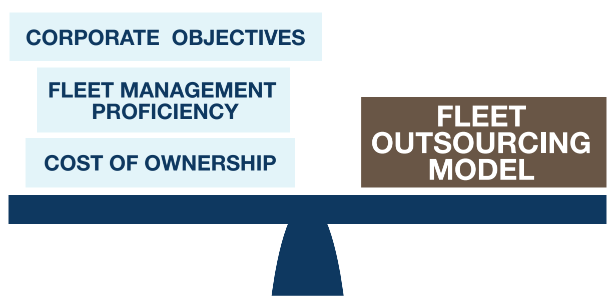
A critical step in weighing fleet insourcing versus outsourcing is determining your "Total Cost of Ownership" (TCO). Your TCO will be a combination of "hard costs" (lease payments, driver wages, repairs, tires, etc.) and "soft costs" (administration, management time and attention, risk and liability, etc.). The soft costs are harder to quantify, but are important to understanding your complete fleet investment.

To assist you in calculating your TCO, Canada Cartage has developed a TCO Calculator™. This tool will help you to identify both the hard and soft costs of fleet management, and provide you with a benchmarking tool to help you make a decision. Contact your Canada Cartage representative to work with you on the TCO Calculator™ by contacting us at info@canadacartage.com.

STEP 4
Benchmark Private Fleet versus Fleet Outsourcing

Now that you have a better understanding of your corporate objectives, current proficiency with fleet management, and your total cost of ownership, the next step is to benchmark this against a fleet outsourcing model. Canada Cartage can provide you with an objective, no-obligation assessment of your current fleet capabilities and costs versus using a dedicated outsourced fleet model.

Benchmark Private Fleet versus Fleet Outsourcing



STEP 5
Decide The Best Path For Your Company!

If you have followed Steps 1 through 4 above, you should have all the information you need to make an informed decision on insourcing versus outsourcing your fleet.

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ABOUT THIS GUIDE

This guide was developed to provide senior management with an objective viewpoint on the advantages and disadvantages of insourced versus outsourced fleet management. It also provides tools to create a framework for the decision-making process to determine if it makes strategic and financial sense to consider outsourcing your private fleet of trucks.

ABOUT CANADA CARTAGE

Founded in 1914, Canada Cartage is the country's largest provider of outsourced fleet solutions, providing dedicated equipment and drivers to both small and large firms. Canada Cartage also provides a complete range of supply chain and logistics services under our subsidiary companies including Direct Distribution Centres, Direct2Home home delivery services, and non-asset based transportation management through our Vanguard Global division. For more information, visit **www.canadacartage.com**.