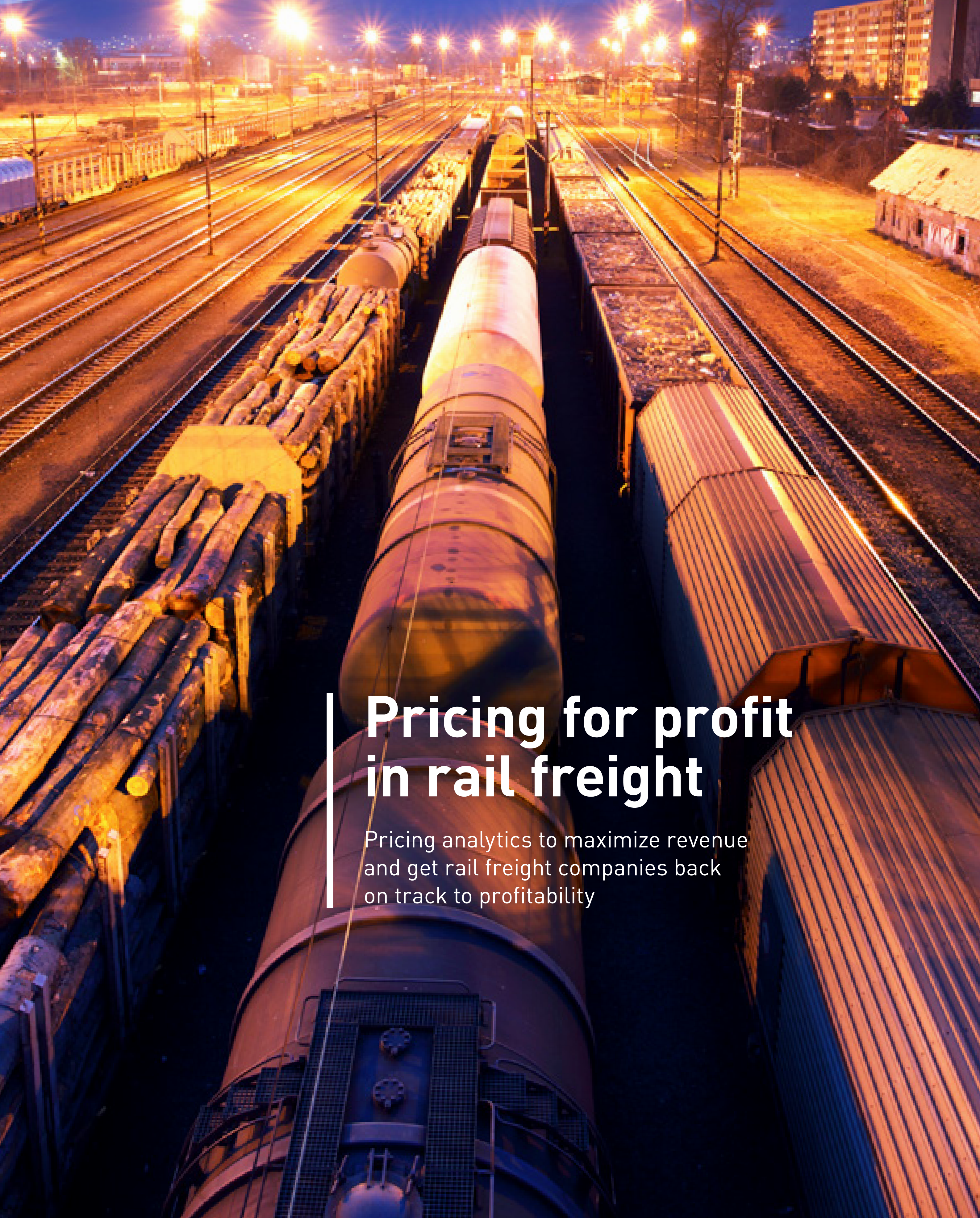

Pricing for profit in rail freight

Pricing analytics to maximize revenue and get rail freight companies back on track to profitability

ADVANCED ANALYTICS

QUINTIQ

The outlook for the rail freight industry is, at best, mixed.

Operators are struggling to cope in a post-crisis world that has seen rail freight shift from being the price-competitive modal transport of choice to one that is, today, up against trucking and air freight — and struggling just to keep up. Liberalization of rail transport in the European Union, the sluggish economy, falling volumes, and supply-demand imbalance have led to drops in rail freight prices. It is becoming increasingly difficult under current circumstances for rail freight operators to earn sustainable margins and create returns for shareholders. McKinsey reports that none of the larger European carriers have achieved average margins of 3% in earnings in recent decades, and at least 7% is needed to cover their costs of capital[1].

To fight against this chronic situation of low profits, operators are aggressively slashing operational costs, cutting personnel, and expanding to other modes of transport. These measures, however, are unsustainable. Financial benefits are shrinking with each round of cuts they make and expansion exercises require massive investments. Furthermore, personnel cuts are a highly unpopular move among state-owned operators.

These crises involve forces that are simply beyond any rail freight operator's control. However, there is one that isn't — pricing.

When done right and enabled by predictive analytics, pricing is the most powerful profit lever available. For decades, fixed pricing strategies have rendered operators unable to adjust their rates in response to market fluctuations, innovate their portfolio of services, or capitalize on market opportunities. Today, these operators are starting to see pricing as an opportunity to defend and expand their share of the market and run profitably in an industry that's predicted to remain largely flat in the coming years.

Research shows that effective price management can increase margins by 2 to 7% in as little as 12 months, and yield a 200 to 350% return on investment.[2]

By tapping into the power of pricing analytics, rail freight operators will stand not only to reap financial gains fast, but secure a strong position to compete — and win — in the future. It's time to rethink pricing processes and technologies to maximize revenue, increase margins, and return to profit. In this paper, we look at:

- Why effective pricing is important now more than ever
- The role technology plays and the benefits it brings
- What to look for in a price optimization solution

Why now?

Your pricing consultant is responding to a query from a customer. After listing his requirements, the customer requests for a quotation. Your consultant's ability to answer this — promptly and optimally — has a direct impact on the overall profitability of your company. The answer given by the consultant is based on static list price, knowledge of what happened in the same period last year, and the judgement call on what the consultant thinks the customer should pay.

This consultant is just one of many in your company. The financial impact of decisions made every day without sufficient data is considerable. The risks of missing opportunities to increase net margin contribution are further compounded by the following factors:

Complexity of rate formulas
Rate structures in rail freight are among the most complex. Costly pricing errors and inconsistencies are commonplace when quotations are made with little data, outdated systems, and spreadsheets. To make truly optimal pricing decisions, you need to look beyond the profitability of a single transaction and understand its impact on your business as a whole.

Complexity of individual contracts
Every customer's requirements are different; so are the specifics of their contract and the size of their contribution to your bottom line. While one consultant's decision to give a discount to a customer may not be felt immediately, the collective impact on revenue is large. Visibility of these contracts enables you to manage long-term profitability from each customer — to maximize revenue from high-contributing segments and better leverage low-contributing segments.

The shift from cost to value
Customers appreciate service that's customized to their specific needs. This is quickly becoming a competitive differentiator. A traditional cost-plus approach may mean fuss-free transactions, but it doesn't maximize revenue. By exploring where you can offer added value and charging accordingly for it, you can maximize revenue without increasing cost.

Poor visibility of rolling stock utilization
The rail freight industry's capacity glut is predicted to worsen in the coming years. When your consultants have poor visibility of rolling stock utilization at the point of transaction and are unable to predict its utilization at the time it leaves the shunting yard, they can't make pricing decisions that maximize the profitability of each item of rolling stock.

Intensifying intermodal competition
Aggressive competition from trucking and air freight is suppressing rail freight prices. Falling fuel prices are reducing the costs of truck transport, which affords trucking companies more flexibility in pricing. To remain price-competitive, you need an innovative pricing approach that takes into account historical pricing patterns and fluctuating market forces to predict and prescribe optimal prices that will edge out the competition and defend your intermodal share.

Inability to respond to market forces
From plummeting fuel prices to unpredictable maintenance to track availability, most market movements are beyond your control. Inability to respond quickly and optimally — whether to capitalize on an opportunity or minimize the effects of a disruption — results in under- or over-pricing. This can mean the difference between profit and loss.

Resistance to technology
Rail freight companies struggle with technology limitations — some still plan with spreadsheets while others are hindered by systems that are not dynamic or flexible enough to cope with variables in contracts, capacity, and networks.

How effective pricing raises profitability — fast

In a volatile market, it's increasingly difficult to maintain profitability, let alone increase it. However, a report by McKinsey, which surveyed of over 1,000 pricing initiatives in B2B industries, shows that the initiatives resulted in a 2 to 7% increase in return on sales[3].

The key enabler of an effective pricing initiative is a price optimization solution that is dynamic, flexible and fully integrated. It gives you end-to-end visibility and therefore, full control over your operations. It uses data and analytics to predict customer behavior and, taking into account all rules, constraints and market factors that affect your business, it prescribes optimal prices benchmarked against business KPIs. Other benefits include:

Significant financial impact
The financial benefits that come with a price optimization solution can be significant. A solution that can be rolled out quickly enables you to realize these benefits fast.

More productive use of time
A price optimization solution reduces manual effort, along with all the pricing anomalies and costly errors that come with it. Your consultants can now focus on other value-added activities such as reviewing pricing strategies, managing pricing campaigns, and evaluating tender bidding processes.

Increased consistency and accuracy
Because it's supported by historical data, the consistency and accuracy of a price optimization solution is assured. By ensuring pricing integrity, you avoid arbitrary decisions that erode your customers' trust in you and safeguard their faith in your brand.

Meaningful profitability insights
A price optimization solution can offer a profitability analysis of both operating costs and revenue at a granular level (e.g. by train service, market service, or customer). This comparative analysis capability equips you with useful insights upon which to formulate alternative or preferential pricing strategies.

Faster, more confident decisions
Your consultants can create what-if scenarios to see the consequences of their decisions before making them — for instance, the operational feasibility of a train movement or the financial viability of a customer consignment, train service, or market service. The ability to automatically predict the consequences and measure the impact of their decisions on the company's overall profitability will greatly increase their speed and confidence in decision-making.

Reverse logistics movements
Because the freight task in many countries is not balanced, with a bias of the freight task in a given direction, there is a need for back-haul movements for fleet balancing reasons. A key component in pricing structure and deal negotiations with clients is to ensure that resultant back-haul movements are factored into the sell price. A price optimization solution takes into consideration the back-haul requirements of all freight consignment movements along with expected revenue opportunities, and uses them as the basis for defining balancing requirements.

Ability to predict and prescribe

Rolling stock utilization
Rolling stock utilization greatly influences pricing — the higher the utilization, the higher the price. A price optimization solution gives consultants real-time visibility of rolling stock utilization as its capacity is consumed and predicts the prices they can quote to customers. By using integrated demand planning, the solution takes into account last-minute changes (e.g. cancellations) to predict how full the wagons will be by the time they leave the yard. These predictions help consultants to consistently quote prices that maximize profitability of each train.

Future demand
You also want a price optimization solution that can help you predict future demand so that you are able to predict capacity utilization and calculate optimal prices.

Revenue
Rail freight operators are able to predict costs accurately, but not revenue. Because most are already slashing operational costs, the only other way to increase profits is to increase revenue. A price optimization solution enables you to predict revenue per train as accurately as possible.

Price sensitivity
The ability to predict the price sensitivity of a customer and therefore, generate higher revenue per train, is powerful. Take, for example, a train with low capacity utilization. By reducing the price marginally, you can increase the demand considerably and generate more revenue from the same train. On the other hand, if capacity utilization is high, you can increase the price up to, but not beyond, the point your customer is willing to pay (price sensitivity) and increase your revenue for the same demand.

You're convinced. Now what?

A commitment to pricing improvement is easy to make, but challenging to execute. Business change, particularly one that involves technology, is rarely successful with a 'big bang' approach. Instead, a prudent plan that gets you from where you are to where you want to be, at a comfortable yet consistent pace, is more likely to be successful.

The best way to begin is to first enlist an experienced analytics team to evaluate where your company presently stands. The team can then map out the stages of price optimization that are unique to your company's objectives. The plan should allow you and your team to build understanding and competency over time, while realizing incremental business benefits at every stage.

Analytics and optimization on a single platform

Quintiq is the only platform on the market that combines analytics with world-class optimization. The platform has multiple business applications in a wide range of industries. When applied to pricing in rail freight transport, it can potentially return your company to profitability and put you in a strong position to compete in the future. Here's how:

Analytics
Quintiq analyzes your company's historical pricing data and takes into account current market fluctuations, rolling stock utilization, customer demand, and your business KPIs to predict a range of market aligned, deal-specific prices that move you closer to your company's revenue goals.

Optimization
The full extent of the Quintiq advantage goes beyond predictive analytics. Incorporating world-class optimization technology, Quintiq can bring your company to the next level of prescriptive analytics. Having broken hundreds of records in the world's most studied combinatorial optimization problems, Quintiq proves that it can offer prescriptive analytics at the highest, most advanced level.

Visibility
The Quintiq solution gives your consultants dynamic and evolving visibility of all price-influencing factors — rolling stock utilization, origin and destination of freight, type of freight, handling requirements, and so on — to aid their decision-making every day. This includes visibility of booked versus available capacity, which enables you to determine the financial health and profitability of any given service at any time. You are then able to innovate additional market services that will help maximize unutilized capacity through standby and weight-listed bookings.

Real time
The more volatile the industry, the more critical agility and flexibility become. Quintiq helps you to swiftly respond to market fluctuations, rapidly adjust prices in response to competitor pricing, and capitalize on opportunities to increase the profitability of each transaction.

KPI-based
Quintiq benchmarks pricing decisions against business KPIs. Your consultants will be able to see not only the profitability of a single transaction, but also the aggregate effects of transactions on overall profitability.

100%-fit
Quintiq is configured to a 100%-fit to your company's unique requirements, rules, and constraints. Updates can be configured into the solution as your business grows, thus keeping it accurate at all times.

Integration
Quintiq can be seamlessly integrated into your company's existing IT framework — whether it's with other Quintiq solutions already in place or with systems from other vendors. The solution's integrated planning capabilities also enables seamless integration between operational performance, events, and the resulting commercial impacts.

Clear user interface
The Quintiq user interface is easy to use and fully configurable to meet the specific requirements of the users. Users have instant access to the commercial and operational data they need to make the best pricing decisions at all times. Automatic detection and notification alerts them to disruptions that threaten profitability — for instance, revenue leakage. Real-time KPI dashboards keep them aligned with company goals.

Quintiq is a supply chain planning and optimization software company with headquarters in the Netherlands and the USA, and offices around the world. Approximately 12,000 users in over 80 countries rely on Quintiq software to plan and optimize workforce, logistics and production. For more information, visit **www.quintiq.com**.

[1] Daniel Girardet, Jurgen Muller, and Anselm Ott; *Getting freight back on track* (McKinsey, 2014) [2] Larry Montan, Terry Kuester, and Julie Meehan; *Getting pricing right* (Deloitte University Press, 2008) [3] Jay Jubas, Dieter Kiewell, and Georg Winkler; *Turning pricing power into profit* (McKinsey, 2015)

Offices: www.quintiq.com/locations
Email: info@quintiq.com | **Web:** www.quintiq.com