INSIGHT

FEBRUARY 2016

ROAD TRANSPORT - SURVIVAL OF THE FITTEST
HOW TRANSPORT COMPANIES HAVE TO COUNTER THE EFFECT OF THE KILOMETER CHARGING SYSTEM
The Belgian road transport sector has been facing some tough challenges in the last decade: the economic crisis, extremely volatile oil prices and a loss in competitiveness because of high labor costs. Even though the economy seems to be recovering and oil prices are reaching record lows, the industry will remain to have a difficult time in 2016, because, yet again, they have to face another challenge: the introduction of the kilometer charging system for heavy goods vehicles (HGVs).

Transport companies have suffered in the past years

Today, c. 8,300 transport companies own 54,000 HGVs on a total of 153,000 HGVs registered in Belgium. Remarkably, 2/3rd of the Belgian fleet is owned by non-transport companies, who keep their transport in-house, mainly for quality and flexibility reasons. Sufficient experience and knowledge of handling particular goods are the drivers behind this approach. The other third of the fleet is owned by transport companies, which have been part of a highly competitive business in the last couple of years. Since 2009, the number of transport companies in Belgium has decreased by 6.5% and the total fleet size shrank more than 10%.

This decreasing trend can be largely explained by two developments. First of all, there has been a shift to foreign countries, mainly for cost reasons. The driver’s wage represents 32% of total transport cost and many haulers have been outsourcing their international transport to foreign subsidiaries, where the labor cost is substantially lower. As a result, foreign HGV traffic in Belgium has increased from 40% in 2005 to 47% in 2010 and this trend has continued in the last couple of years.

Secondly, companies have been using other means of transportation, especially barge and rail have gained popularity in the last decade. These transport solutions are becoming more accessible, mainly because the European Commission is subsidizing and investing in infrastructure in order to decrease pollution and avoid congested roads. Between 2004 and 2013, the importance of barge increased up to 20% and the importance of rail freight transport grew to 15%.

The transport companies that remained successful in Belgium were the ones who diversified their activity portfolio and who started to perform additional value-added services such as packaging, labeling, warehousing or customs operations. By doing so, they better integrated with their customers and they limited the importance of the transport component, at the same time. It makes them less vulnerable to the high price pressure of the many small and independent transport companies in Belgium or low cost suppliers from abroad.

With the introduction of the kilometer charge in Belgium, they now have to face the next challenge.
The kilometer charge will increase the cost of national transport with almost 8%

After many years of preparation and supported by successful examples in other European countries, the Eurovignette in Belgium will be replaced by a kilometer charging system for HGVs on April 1\textsuperscript{st} 2016. All trucks with a Permissible Maximum Weight (PMW) of more than 3.5 ton are the scope of this new toll system.

The toll will vary depending on the type of vehicle, and more specifically its emission class and PMW. According to a simulation of the ITLB (Institute for road Transport and Logistics in Belgium), the cost will increase with almost 8% for national transport and between 3% and 7% for international transport. Tariffs in Brussels will be higher than in the surrounding regions and an increase of more than 12% is expected. The increase is important for a highly competitive sector, already suffering from severe price pressure and haulers are taking action to cope with this new threat.

<table>
<thead>
<tr>
<th>Average Cost Increase (IN %)</th>
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<table>
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<tr>
<th></th>
<th>Cost Increase</th>
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<tbody>
<tr>
<td>National Transport</td>
<td></td>
</tr>
<tr>
<td>Piece Goods</td>
<td>8,02%</td>
</tr>
<tr>
<td>General</td>
<td>7,94%</td>
</tr>
<tr>
<td>In Centre of Brussels</td>
<td></td>
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<tr>
<td>Piece Goods</td>
<td>11,11%</td>
</tr>
<tr>
<td>General</td>
<td>12,40%</td>
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<tr>
<td>General International Transport</td>
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<tr>
<td>The Netherlands</td>
<td>4,45%</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>7,05%</td>
</tr>
<tr>
<td>Germany</td>
<td>3,12%</td>
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<tr>
<td>France</td>
<td>2,97%</td>
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Evidently they will try to charge the toll directly to the customers. However, the question remains if customers will simply accept this. We expect many of them have already or will try to push back the price increase to the transport company.

In our opinion, it is clear that transport companies need to take action in order to counter the impact of the kilometer charging system. The haulers that are the most cost effective will be the winners and will create an excellent opportunity to gain market share.

In the following paragraph we will zoom in on the different actions that haulers can take to level off the effects for their customers and by doing so, creating winning sales strategies.

The HGV fleet needs to be reorganized for cost avoidance reasons

Fleet renewal is the most logical, but expensive step to take

The first and most logical step to take is the investigation of the fleet renewal: the older the fleet, the less it scores on emission class. As tariffs are based on the emission class of the vehicle, it can be expected that many haulers will take the option to make their fleet greener and as such minimize the impact of the kilometer charge.

<table>
<thead>
<tr>
<th>Age of HGVs (2011)</th>
</tr>
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<tbody>
<tr>
<td>TRUCK</td>
</tr>
<tr>
<td>--------</td>
</tr>
<tr>
<td>0-2 YEARS</td>
</tr>
<tr>
<td>3-5 YEARS</td>
</tr>
<tr>
<td>6-10 YEARS</td>
</tr>
<tr>
<td>11 YEARS OR OLDER</td>
</tr>
</tbody>
</table>

Source: Federal Public Service Mobility & Transport

With 40% of the fleet being more than 11 years old, Belgium has a lot of green potential and we could expect a similar trend as in Germany, although not as outspoken due to differences in governmental side measures. In Germany 18% of the vehicle kilometers were driven by HGVs with EURO V before the introduction of a similar kilometer charging system. Four years after the introduction, this percentage rose to 70%.

Will the Ecocombi break through?

A second, slightly more difficult step to investigate for haulers is the optimization of the fleet according to PMW, the other parameter of the tariff.

<table>
<thead>
<tr>
<th>Registered HGVs per PMW Class (2014)</th>
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</table>

Source: FEBIAC
The tariff increases significantly for more than 12 ton and is capped at 32 ton. Theoretically this means that it is most cost effective to drive with an HGV that has a PMW just below 12 ton or a lot more than 32 ton.

Trucks between 8 and 12 ton have a competitive advantage compared to the more heavy ones and we advise haulers to investigate the possibilities of shifting flows towards this category in the coming period.

In addition, haulers should keep an eye on the evolution of the supertruck or ecocombi, which has a PMW of 60 ton, to significantly reduce the impact of the kilometer charge. Finland, Sweden and Denmark have successfully introduced these trucks since many years. More recently The Netherlands and Germany are experimenting with success. Lower fuel and salary cost benefit the bottom line of the transport company. In Belgium a first pilot with the ecocombi has set sail early 2015. As part of an ambitious green logistics plan, AB Inbev has replaced 3 normal trucks by 2 ecocombis to reduce the number of trips, while transporting the same volumes.

Evolution of registered HGVs and vans

<table>
<thead>
<tr>
<th>TRUCK</th>
<th>3.5-12 TON</th>
<th>12-32 TON</th>
<th>&gt;32 TON</th>
</tr>
</thead>
<tbody>
<tr>
<td>EURO III</td>
<td>€ 2.090</td>
<td>€ 2.805</td>
<td>€ 2.863</td>
</tr>
<tr>
<td>EUR IV</td>
<td>€ 1.803</td>
<td>€ 2.519</td>
<td>€ 2.576</td>
</tr>
<tr>
<td>EUR V-VI</td>
<td>€ 1.360</td>
<td>€ 2.075</td>
<td>€ 2.133</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>TRACTOR</th>
<th>3.5-12 TON</th>
<th>12-32 TON</th>
<th>&gt;32 TON</th>
</tr>
</thead>
<tbody>
<tr>
<td>EURO III</td>
<td>€ 6.741</td>
<td>€ 9.049</td>
<td>€ 9.234</td>
</tr>
<tr>
<td>EUR IV</td>
<td>€ 5.817</td>
<td>€ 8.126</td>
<td>€ 8.310</td>
</tr>
<tr>
<td>EUR V-VI</td>
<td>€ 4.386</td>
<td>€ 6.694</td>
<td>€ 6.879</td>
</tr>
</tbody>
</table>

The simulation shows that there is a minor cost difference between an HGV with a PMW between 12 and 32 ton and an HGV with a PMW larger than 32 ton. It also indicates that it is most cost effective to use vehicles with at least emission class EURO V. It is not unimportant to mention that from 2018, a differentiation will be made between EURO V and EURO VI vehicles.

Vans are not subject to the kilometer charge and can be introduced in the fleet

A third element to investigate is the introduction of vans in the category of 3,5 to 8 ton. It is a feasible option since this kind of tax evasion has already been seen in Switzerland, where a combination of a van and a trailer is allowed to carry up to 7 ton without paying the Swiss kilometer charge.

In the current Belgian legislation, a van does not have to pay the kilometer charge if it has a PMW below 3,5 ton and the combined weight of the van and its trailer does not exceed 12 ton. We therefore encourage haulers to take advantage of this solution and introduce vans in their fleet, if possible. It is not easy to implement and a feasibility analysis of the infrastructure and operations is necessary.

In general there has already been a shift from HGVs to vans in the last couple of years, mainly explained by the increasing importance of e-commerce and the increased use of vans for urban distribution. We now expect that the share of vans will continue to grow under the impulse of the kilometer charge.

Recovery of the cost increase through further optimizing processes

Haulers should work together with their customer base

Haulers have to map their flow of goods and see if they can realize a more efficient transport flow. This can improve the load factor and reduce the number of empty trips. In order to avoid price increases, customers will be more open to collaborate with
their suppliers in order to find additional cost measures that further decrease the impact of the kilometer charge. Pooling the transport of different clients, reorganizing the distribution network, reanalyzing the frequency of deliveries, eliminating waiting times, ... to name a few.

To support this customer focus, transport companies should start with a profitability analysis per customer, by defining cost drivers and attributing the right costs to the right customers. This allows them to benchmark their clients and to look for specific cost saving measures per customer. For example, a hauler can optimize the communication with a specific customer in order to reduce long waiting times.

Look for additional efficiency gains inside the own organization

Increasing revenues and decreasing costs, top line increase and bottom line impact is the mantra for the next years.

Focusing on companies that currently take care of their transport in-house could be an interesting way forward. As 2/3rd of all HGVs are owned by non-transport companies, there is a large potential. The introduction of the kilometer charging system will make the organization of in-house transport process more complex and pricy, making outsourcing a viable alternative to keep costs under control. Haulers that actively target this part of the market will have a great opportunity to increase their market share.

On the cost side, the transport companies have to perform an in-depth analysis of their own cost base. They have to map, analyze and streamline their internal processes in order to remove all dysfunctions and to realize efficiency gains.

Route planning optimization

Another way of reorganizing its business and minimizing the cost impact of the kilometer charging system is the optimization of the route planning. Rerouting of some trucks off the motorways onto other non-taxied roads could be effective. In international transport, the long distance transport patterns could result in avoiding some countries. But also on a more local level this could have an important impact. When more than one alternative routing is possible between origin and destination, substantial rerouting effects on the transport flows are possible. This has been the case in Germany. When they introduced the kilometer charging system an intensified use of alternative cost saving routes has been noted as c. 25% of the secondary roads have faced an important growth of the number of HGV’s.

Conclusion

There is no doubt that the introduction of the kilometer charging system in Belgium will have a big impact on the transport industry. The main question is if the haulers will be able to charge the toll directly to the customers or not? It can be expected that customers will actively look for alternatives in order to avoid this price increase. Transport companies have to anticipate the customers’ reaction and will have to take countermeasures in order to minimize the cost impact of the kilometer charging system. The haulers that are successful in this mission, will be able to increase their market share in the short term.

In order to achieve this, haulers have to reorganize their fleet and adjust it to their business needs. They have to green the fleet and offer a range of vehicles with different Permissible Maximum Weights adjusted to their needs. On top of this, they have to investigate if they can use vans since they are not subject to the kilometer charge. Secondly, they have to map their transport flows and work together with their customer base to further reduce the impact of the kilometer charge. Next, they have to attract new business by targeting enterprises that currently organize their transport in-house. They also have to streamline their internal processes. Finally they should investigate the use of alternative cost saving routes.

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