

Strategic management in the Australian road freight transport industry

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Abstract:

Owner drivers in the road freight transport industry provide a major means for corporate sector risk management, strategic management, growth, and development to positions of industry dominance and industrial relations. This is made possible by a continuous supply of owner drivers who enter into a range of dependency relationships with the corporate sector where they are exploited to a greater or lesser degree. Risk management through dual labour-management systems is the key to the strategic management of global transport companies. It is a unique system of strategic management which has proven extremely successful.

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Introduction and overview

A characteristic of the highly competitive road freight sector of the transport industry in Australia is the complex relationship between the corporate sector, represented predominantly by a small number of large freight forwarders and the small business sector, represented by owner drivers and small fleet operators. This relationship is one of mutual dependence between owner drivers and principal contractors.

In this paper the nature, purpose and important consequences of this dependency relationship are examined from several theoretical perspectives in the context of road freight. In the process, arguments, with some supporting evidence, are advanced to explain the strategic and operational advantages of owner driver use by the corporate sector. The reasons for the existence of a continuing and sometimes excessive supply of owners drivers are not explored herein for the sake of brevity but they are more complex than generally reported. They are addressed in a forthcoming paper by one of the authors (Donohue).

These introductory remarks are followed by a discussion about definitional imprecision for owner drivers because it is symptomatic of the complexity of the contractual associations in the industry. There follows discussion of the economic structure, conduct, performance and labour-management characteristics of the general road freight transport industry. Analysis of the use of owner drivers by the corporate sector as instruments of risk management follows. Finally, some of the advantages and consequences of the dependency relationship for principal contractors are explored.

Owner driver numbers

Present institutional arrangements preclude the possibility of obtaining an accurate estimate of either the population or fluctuations in the rate of change of owner drivers in Australia. During the last decade owner driver numbers have been variously estimated between 10,000 and 22,000 (see Hay 1980 and Bureau of Transport Economics [BTE] 1984, 1986).

Moreover, there is no systematic account of the reasons for changes in the owner driver population although there is some evidence which may account for certain types of change. The National Road Freight Industry Inquiry [NRFII] (1984) suggested that population determinants included factors such as cyclical fluctuations, fluctuations in freight rates, market share and increasing economies of scale obtained by freight forwarders (May Report 1984, Ch 2). However, there is little research published on other interesting owner driver features such as: the nature and extent of new entrants; their longevity; their motives for entering and remaining in the industry; and their contractual relationships with freight forwarders and fleet operators.

What is known about owner drivers is derived from submissions to and studies cited or commissioned by the NRFII (1984, pp. 489-519) and unpublished

theses (e.g. Bray 1989, McDonnell 1986). Indirect sources of information are obtained from surveys of small business (e.g. A J Williams 1987) and follow up studies on bankruptcies (Small Business Development Corporation [SBDC] 1990, Webb 1984).

These information gaps arise due to the nature of data collections, industry representation and lack of definitional precision. Firstly, the Australian Bureau of Statistics (1985) does not recognise owner drivers as an occupational classification, nor do the States recognise owner drivers as a distinct category for motor vehicle registration and financial data collection (e.g. licence fees) and as a result many transport workers are classified as being part of the industry they service such as retailing, manufacturing or agriculture.

Secondly, the nature of owner driver industry representation makes estimation of their numbers difficult. During the 1980s as many as 8 organisations have been variously cited as representing owner drivers (see Hay 1980, pp.11-48; ISC 1986, pp. 86-87). Owner drivers perceive themselves in different roles at different times. This creates difficulties in classifying them industrially and accounts for the failure of most owner drivers to become members of a representative organisation (see Hay 1980, p.7; ISC 1986, p.86).

Thirdly the absence of a standard definition of an owner driver implies that any numbers produced will be imprecise. This paper will use the definition of an owner driver as a single vehicle self operator for the sake of convenience (NRFII 1984, p.476; ISC 1986, p.570). In fact the diversity of agency relationships between freight forwarders, fleet operators and owner drivers defy a comprehensive definition. Moreover, the definition adopted does not address these relationships either. Yet, the relationships are critical to the understanding of the dependency relationship between owner drivers and the corporate sector. Owner drivers have been classified in a number of ways with the most common being variations of the system used in NRFII (1984). In this system owner drivers may be prime contractors or subcontractors, who act as tow operators or supply both the prime mover and the trailer and as subcontractors may be independent or freelance or enter into permanent or semi-permanent arrangements with freight forwarders and fleet operators as painted or tied operators and specialist subcontractors (NRFII 1984, p.17)

These classification systems only partly explain the range of working relationships which exist. The relative importance of the dependency relationship is reflected in a number of dimensions which include: the segment of the road transport industry; the nature of the freight, the distance between origin and destination, location, the nature of the contractual arrangements, the structure and conduct of the industry participants; and the position of individual owner drivers on the independent/permanent subcontracting continuum. None of these dimensions is explored in this paper other than in the most general terms.

Industry structure, conduct, performance and labour-management practices

The road freight transport industry as a door-to-door operation is best analysed as a vertically integrated oligopoly (few freight forwarder acting as sellers, many customers). Owner drivers are subcontracted in an oligopsonistic submarket (few freight forwarder acting as customers, many owner driver acting as sellers). Vertical integration minimises transactions costs between individual trip segments and offers service attributes including quality service dimensions such as safety, security, speed and guarantee of delivery time, complexity of task and the avoidance of loss, spoilage and breakage.

Competition reduces rates to unprofitable levels in the shortrun for many owner drivers. This leads to pursuit of ways to reduce costs, some of which may be illegal. The market structure which has evolved in road freight transport has accomplished this objective for a significant few. In terms of market concentration ratios, the present road freight economic structure for freight forwarders is characterised by oligopoly. Fringe dwellers in the primary service market operate with weak monopoly power over rates. Fleet owners have some monopoly power but owner drivers have nil (see NRFII 1984, Ch 2 for more detail). The inability of transport brokers to effectively operate in the road freight market means that alternative sources of subcontracting for owner drivers are limited, forcing reliance on freight forwarders (see Tradestock Case in Trade Practices Commission 1985, pp.14-22, 113).

The performance attributes of owner drivers significantly influence labour-management practices of freight forwarders. The economic characteristics of the road freight transport industry are, to some extent, consistent with the collection of reasons given by the management of road transport companies, acting as freight forwarders and principal contractors, for using owner drivers (see NRFII 1984, p.43). Owner drivers offer demand and cost advantages. Their demand advantages relate to sales growth, by market share and new services, through subcontracted services. Their cost advantages relate to vehicle utilisation and management.

As a cost advantage, owner drivers reduce union power and its consequences. In short they are a labour-cheapening strategy on the part of freight forwarders. Historically, this strategy may have been an important consideration in curbing the development of union power, following the deregulation of interstate road transport and the emergence of freight forwarding. Road industry legislation, as a consequence, permits and encourages the co-existence of a highly regulated and a highly unregulated labour market. The impact on union power in the transport industry is however ambiguous. In certain sectors of the industry where particular task circumstances prevail both permanent employees and the more permanent and dependent owner drivers, organised in autonomous work groups, may exert considerable power. The latter frequently exert as much or more power than their permanent employee counterparts (e.g. Queensland Transport News 1988, p.16).

The historical motive to reduce union power may still be an important consideration in some sectors of the road freight transport industry. If overall union power has declined, managers may now perceive the respective powers of owner drivers and permanent employees in largely neutral terms. Accordingly, union power becomes neither a compelling nor sustainable reasons for choosing

owner drivers. Union power is no longer the determinant factor. Rather, the determinant factor is the corporate sector's interest to encourage and maintain a dual system of industrial relations through the system of dual supply. The coexistence of permanently employed drivers and contracted drivers provides the corporate sector with a powerful means of control and for industrial relations bargaining and negotiation. The dual labour system exerts both service and wage-price discipline upon permanent and subcontract drivers.

As a cost advantage owner drivers reduce costs in maintenance, through more efficient capital utilisation, lower effective rates of pay and economies in organisational overheads by freight forwarders (see NRFII 1984, p.43). The comparative advantage emanates from a combination of (i) an excess supply and/or dependent supply of owner drivers competing in terms of price and (ii) management awareness of the existence of organisational overheads faced by the principal contractor which are either not incurred, perceived or fully accounted for by owner drivers.

Despite the economy of owner drivers road transport freight companies employ permanent labour. Predominantly they are employed for tasks of a non-routine or strategically sensitive nature (see Donohue). Specialised or complex movements require permanent drivers where the risk of non-substantiation is correspondingly high. Where the need for control is paramount strategically, either in terms of the market characteristics themselves or in terms of the production process itself, permanent drivers are deployed. This relates particularly to the provision of service quality attributes beyond those associated with mere delivery of freight at the market determined general freight rate. The increasing prevalence of the use of long term contracts between clients and principal contractors means that the risk of contract non-conformity assumes greater importance than the spot contract situation, thereby demanding the choice of permanent labour to service the contract work. In short, both task-specific and contract-specific attributes influence the choice of driver labour.

Owner drivers offer scheduling advantages. They are willing to work longer and more flexible working hours than the regulated permanent employees. Additionally, owner drivers assume the problems of vehicle downtime (e.g. dead running, accidents, maintenance and repairs).

The consequences for owner drivers assuming this particular role for road freight transport companies are highly significant. The necessity for cash flow means that the search costs for more rewarding contractual associations are relatively high. Driver networks appear to determine the quantity and quality of economic data. With very limited opportunities to determine relative prices, owner drivers resort to output adjustment strategies that perpetuate a range of undesirable practices and illegal acts such as undercutting agreed rates and tax evasion through cash payments (NRFII 1984, p.44), not to mention drug abuse, speeding, overloading and other malpractices reported regularly in the press. These practices, if not condoned by road freight transport companies, are recognised and expected, as confirmed by the practice of some companies paying the fines incurred by owner drivers for speeding and overloading (Scott 1984, p.54 reported in NRFII 1984, p.46). The recent deregulation of the long distance bus industry produced similar rate-schedule competition and speed problems. The consequences of this production transfer mechanism are negative externalities borne by government and

society. The most obvious externalities being the injuries and death from road accidents and the excessive wear and tear of the road system .

While the industry structure and the attributes of owner drivers have effected labour-management practices the fundamental rationale has yet to be discussed, risk management.

Risk management and owner drivers

The continuous supply of owner drivers has enabled the corporate sector to take advantage of their relationship with owner drivers. The latter's attributes have formed an integral part of the strategic management of risk and uncertainty by freight forwarders.

The economic structural determinants and conduct attributes of the road freight transport industry, together with the nature of the tasks performed in certain of its market segments, facilitate the use of owner drivers by the corporate sector as part of their risk management strategy. The reasons for using owner drivers discussed in the previous section, become, under a conceptual framework of risk management, elements of risk management strategy. However, it is not sufficient to state that owner drivers confer a risk advantage on the corporate sector. It is necessary also to explain the conditions which permit the advantages to exist, to identify the nature of the risks, to determine the dimensions of the risk advantages and to account for the changing nature of the risks over time which owner drivers are instrumental in reducing for the corporate sector.

Risk preconditions

There appear to be several preconditions, other than the industrial relations system and the market structures which have evolved in the road transport industry. The industry's structure characteristics in turn, appear to be the major factors responsible for the risk changes over time.

The first precondition is the opportunity to contract. Contracting is a feature of road freight transport. Where the market structure and industrial relations environment permits, the use of contract labour is possible at the extremes of task simplicity and complexity. In significant sectors of the road freight transport industry, the nature of the task is simple. It is easily understood by all parties. It does not involve quality dimensions over and above that embodied in the general freight rate. The opportunities for direct human supervision are limited because of the nature of the work, even though minimum interference in the work process is required and, most importantly, the effective completion of the task requirements is easily substantiated. Furthermore, control has been made easier with the passage of time through technological change in the form of improved communication systems and the introduction of complex computer information and logistical

systems. These systems provide the road transport and transport industries generally, with the ability to organise, cost and control the production process, financially and administratively, down to the level of atomistic elements of the process. Technological change, together with the dual system of industrial relations, permits the extension of tasks by principal contractors to owner drivers which were previously withheld. However, whether these tasks will be undertaken by owner drivers or not depends on other preconditions and the nature of the tasks to be performed.

The second precondition is that road freight transport managers assess the potential for owner drivers to become direct competitors as minimal. The industry structure for freight forwarders which incorporates the presence of significant scale economies in the form of marketing, control and coordination virtually precludes this threat from gaining substance. When owner drivers attempt to directly compete with principal contractors, including freight forwarders, as frequently occurs, it is shortlived and therefore manageable. This implies that barriers to entry in the form of scale economies apply to a significant proportion of fleet operators as well. Management adopts this particular risk stance to the owner drivers due to the (i) industry's market structure and conduct characteristics, (ii) the existence and exploitation of the dependency relationship and (iii) the attributes characteristic of owner drivers. The latter is not addressed in this paper.

The third and overriding precondition emanating from the other preconditions is that owner drivers are less costly to use both in terms of the market and the command economy (internal organisations), as suggested previously (NRFII 1984, Ch 2).

Nature of risk

To this point the discussion of risk management has centred on the motives of management for such action. However, these motives are incomplete and do not exhaust the possibilities for risk management provided by owner drivers.

Obvious and major risks, not previously mentioned, are the cyclical, structural and seasonal fluctuations in quantity and market price. The risks associated with these market fluctuations are assumed mainly by owner drivers. Variability of freight movement by volume, type, route and season dictates access to flexible capacity for sustained competitive advantage. Adverse road and weather conditions disrupt schedules and increase costs. Thus the risks of variability and adversity are contained by subcontracting.

There are other forms of risk which are associated with various types of adversity, with the most noticeable being the consequences of accident, breakdown and loss of a driving licence. To some extent, these forms of risk and their consequences, are assumed both by owner drivers and society as a whole.

Few other industries have access to both the types of data bases and the industrial relations systems which exist in the road freight sector, and the road transport industry generally, and the ensuing profits.

In these circumstances, the labour selection process, unencumbered by industrial relations limitations, can be explained simply in formal organisational economic terms (Williamson 1976). To the extent that management is able to identify the range of risks and accurately assign probabilities to likely outcomes in their calculation of the values of benefits and costs, an internal labour market will be preferred to a contract work force of owner drivers when the benefit cost ratio is greater. The assignment may be intuitive or deterministic depending on the quality of management and data. Deviations from this position will occur under conditions of uncertainty and when risks are either not known or cannot be valued accurately.

Simple cost and performance attributes do not produce dominance of either form of labour-management relationship. It is necessary for the corporate sector in the road freight industry to use both forms of labour simultaneously, if they are to achieve their objectives of long run profitability and growth. The achievement of these objectives is enhanced if owner drivers become dependent on the corporate sector. Furthermore, the major benefits obtained from the use of owner drivers cannot be measured in conventional economic terms. These benefits relate to managerial control and are discussed in the next section.

Implications for the corporate sector

The range of working arrangements, which extends from freelance, independent owner drivers at one extreme to specialised, tied and painted owner drivers at the other extreme, provides one measure of the dependency relationship between owner drivers and the corporate sector. It is the relative stability of the more dependent relationships which, given the environmental circumstances for their establishment, provides the necessary level of certainty for the corporate sector to use owner drivers as the major instrument of risk management. Moreover, the advantages of the arrangements for the corporate sector are not confined to risk management.

Firstly, owner drivers permit road freight transport companies to operate with relatively small capital bases and individual business units compared with either the large volumes of freight carried or the amount of revenue generated. This is akin to capital gearing in finance theory, except the capital is borrowed at no explicit interest cost. The optimum size of each business unit appears to be closely related to a size which is sustainable if expectations about the effects of any downward fluctuations in the level of activity should eventuate. Owner drivers provide a source of flexibility. Not only do owner drivers suffer the effects of any downturn, but also, during periods of increased activity, they effectively act as substitutes for internal organisational expansion. In the absence of owner drivers such companies would have to expand their fleets and middle management to cope with the growth.

Secondly, owner drivers provide the means by which the corporate sector consistently obtains substantial profits, from road freight operations. This is despite being in a competitive industry in which the profit margins are small. Freight

consolidation generates revenue at only marginal costs on regular routes. The substantial profits derive from a combination of the large volumes of freight carried, the high industry growth rates recorded and the economic capacity of the corporate sector to secure a distribution of available profits which is favourable to themselves. Support for this distributional outcome is obtained from: longrun growth of the freight forwarders' networks globally and their consolidation into a small number of companies; and the low financial returns recorded by the less dependent and less financially secure owner drivers. In theory the extent to which the income distribution process is adopted by the corporate sector will extend to the point economically, where it is impossible for owner drivers to earn excess profits. Other things being equal, owner driver instability and failure occurs when this point is misjudged by the corporate sector.

Thirdly, owner drivers provide the corporate sector with a degree of choice in the utilisation of scarce human and capital resources. The savings obtained from not having capital "tied up in vehicles" is an advantage obtained from using owner drivers (NRFII 1984, p.43). The advantages extend beyond vehicles, however. Less equipment, land, maintenance facilities, ancillary services and labour are required as well. Moreover, the time saved in routine direct supervision of the workforce can be utilised by management on other activities such as planning and tendering. Management can focus on market share expansion and realising potential markets. The capital released together with the combination of other opportunities derived from owner driver use and deregulation has enabled a few firms to grow and dominate the road freight transport industry. Correspondingly, whatever power owner drivers may have enjoyed at times in the past has been eroded progressively and replaced by various forms of dependency in most market niches. Thus, in road freight the opportunity cost of capital is high because the opportunities available for the alternative use of capital within the firm are substantial. The supply of transport services is less profitable than the marketing of transport services.

Fourthly, the use of owner drivers ensures that administrative costs and production on-costs are either avoided or reduced, depending on the proportion of owner drivers used in a business operation (as noted, NRFII 1984, p.43). These costs include workers compensation, superannuation, pay roll tax, holiday pay, long service leave and driver training. As a result cash flow is preserved, working capital is enhanced, income tax is reduced and the costs of labour regulation offset.

Fifthly, the conditions which permit the use of owner drivers and the combination of advantages which derive from their use, has produced performance oriented corporate organisational structures concerned with road freight, which are relatively simple and lacking in elaborate hierarchy. These types of organisational structures extend to other forms of road transport activity as well.

These five conditions have produced freight forwarding companies with relatively small but expert groups of senior managers, assisted by limited technical and administrative support personnel. They are able to enlist the use of modern technology and sophisticated financial and operations research techniques not only to price, cost and distribute the services provided but also to monitor, control and evaluate service and workforce performance. Their production workforce consists mainly of relatively large pools of semi-skilled and unskilled labour either in permanent employment with few opportunities for advancement or development within the organisational structures, or on contract as owner drivers. *Management*

of individual business units within the corporate structure is focused on marketing and maintenance of customer services.

As a consequence of the forgoing, freight forwarders' personnel management functions are limited and handled by line management. These functions are concerned predominantly with maintenance and control of performance dimensions, expressed mainly in terms of the achievement of physical and financial targets, rather than personnel development such as the selection, training and promotion of the internal production workforce. On the other hand, industrial relations functions are extensive and, in the main, entrusted to senior and line management. This is not unexpected, given the importance of owner drivers to the corporate sector. The preservation of the existing industrial relations environment and its effective management are essential requirements for corporate performance.

The relatively simple organisational structures facilitate managerial effectiveness. Management is able to concentrate its energies on the external market environment rather than the internal production process. This output related market orientation is in marked contrast to the input related production process orientation observed in many firms in other industries.

Given the major advantages, it is not surprising that road freight transport companies are known to actively encourage permanent employees and others to become owner drivers, when the appropriate circumstances exist, by varying degrees of financial inducements.

It is clear that owner drivers are one of the main bases for the evolution of a few dominant firms in the road freight transport industry and provide the necessary means for these firms not only to maintain and consolidate their dominant positions in the market but also to control their internal environments, particularly the regulated permanently employed drivers.

Conclusion

Owner drivers in the road freight transport industry provide a major means for corporate sector risk management, strategic management, growth and development to positions of industry dominance and industrial relations. This is made possible by a continuous supply of owner drivers who enter into a range of dependency relationships with the corporate sector where they are exploited to a greater or lesser degree.

The dependency relationships are multidimensional, with the owner driver "typology" systems of classification being the most obvious forms of dependency. Each type of relationship represents a particular range of interests and aspirations for individual owner drivers. The more permanent and stable the relationship the more owner drivers perceive themselves as employees rather than self employed small business operators.

The potential for conflicts of interest to emerge among owner drivers in the multitude of existing dependency relationships means that no single effective organisation is likely to emerge to represent their diverse collection of causes. Yet,

only through the establishment of an effective representative organisation can the economic and working conditions for all owner drivers improve.

Risk management through dual labour-management systems is the key to the strategic management of global transport companies. It is a unique system of strategic management, not reported in the literature. It has proven extremely successful.

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