SONAR

SOLUTION GUIDE

A Guide to Rates: Spot vs Contract

Overview

Understanding the difference between spot rates and contract rates is crucial for shippers, brokers, 3PLs and carriers. This guide delves into the intricacies of these two types of rates, their impacts on the freight market, and how they can be leveraged for optimal performance. By using SONAR tools such as Market Dashboard, Market Dashboard+ and Supply Chain Intelligence (SCI), stakeholders can make informed decisions regarding the dynamic of spot and contract rates, manage costs effectively, and respond proactively to market changes.

Key Benefits/Takeaways:

- **Comprehensive understanding:** Gain a clear distinction between spot and contract rates
- **Market insights:** Learn how spot rates influence contract rates and vice versa
- **Strategic utilization:** Discover strategies for optimizing the use of spot rates
- **Decision-making:** Use SONAR tools to enhance market responsiveness and cost management

What Is a Spot vs. a Contract Rate?

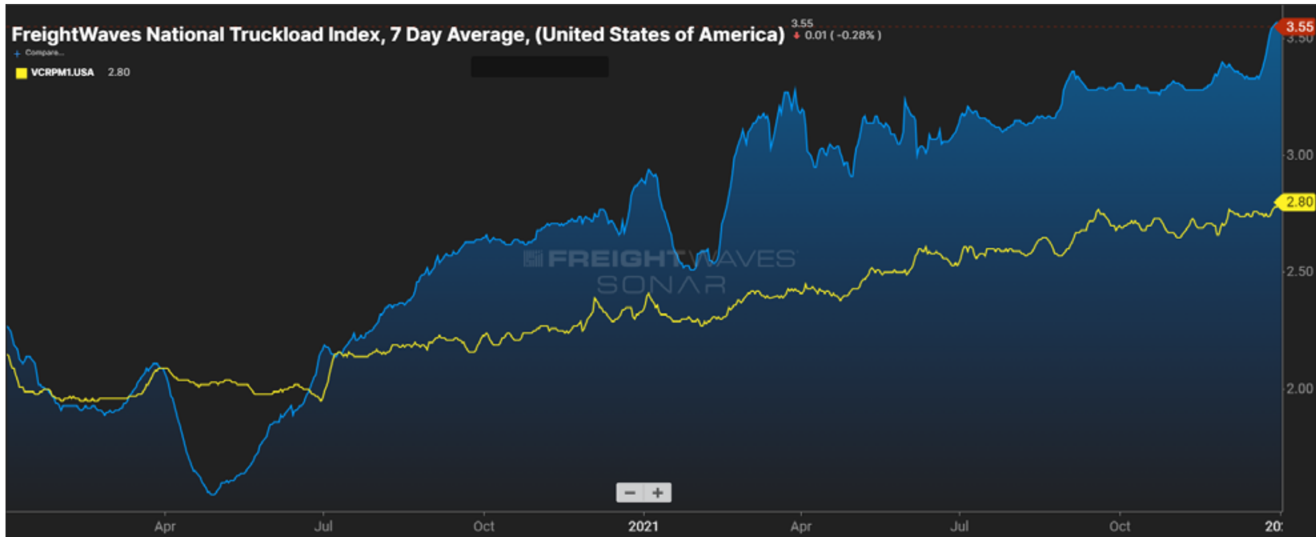
A spot rate is the price at which freight is booked on a short-term basis, or "on the spot," often for a single shipment or for a short duration. Spot rates are highly volatile and are influenced by immediate market conditions, such as supply and demand fluctuations, fuel prices and capacity availability. Spot rates are typically priced as all-in rates, meaning the rate includes, at a minimum, linehaul and fuel cost.

A contract rate, on the other hand, is a pre-negotiated rate between a shipper and a carrier for a specified period, usually ranging from several months to a year. Contract rates provide stability and predictability in freight costs as they are less susceptible to short-term market fluctuations. Contract rates are typically set via a request for proposal (RFP) and involve multiple bidding rounds between shipper and carrier. The majority of freight moves via contract rates.

How Do Spot Rates Impact Contract Rates?

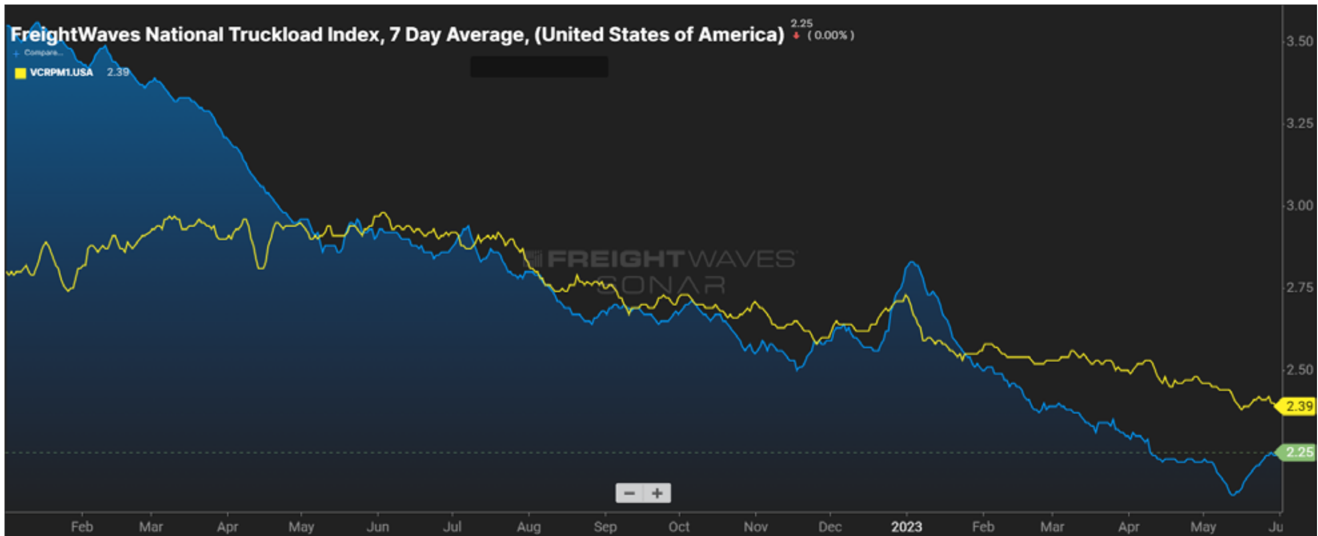
Carrier Market vs. Shipper Market

In a carrier market, where demand for freight capacity exceeds supply, spot rates tend to increase, at times above the price of contract rates. This encourages carriers to favor spot market transactions, potentially driving up contract rates during renegotiations as carriers seek to capitalize on favorable market conditions.



Looking at the chart above, spot rates in blue rose above contract rates in yellow during a period of high freight demand and low carrier capacity, creating upward pressure on contract rates. As shipper contract rates came due for renegotiation, carriers were able to seek higher contract rates capitalizing on favorable carrier market conditions.

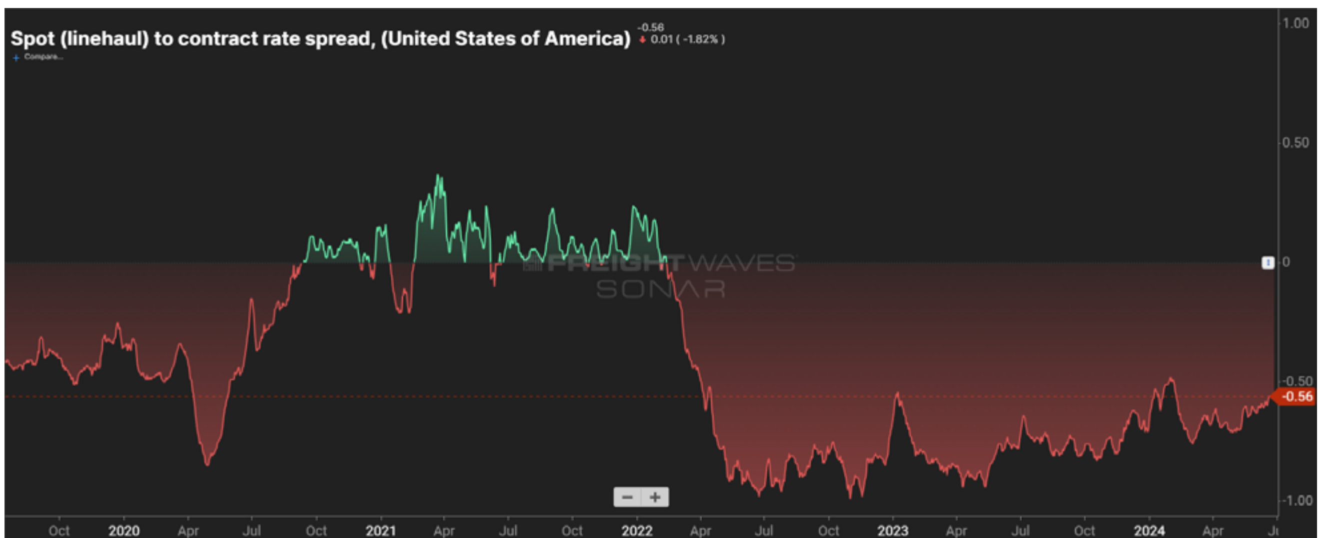
Conversely, in a shipper market (where supply exceeds demand), spot rates are often lower than contract rates. Shippers can leverage this by pushing for lower contract rates during renegotiations, using the current spot market conditions as a benchmark. If spot rates are dramatically lower than contract rates, contract rate freight is the best-paying freight in the market and carriers have little power to resist shippers repricing their contract rates lower.



Looking at the chart above, spot rates in blue dropped below contract rates in yellow during a period of low freight demand and high carrier capacity, creating downward pressure on contract rates. As shipper contract rates came due for renegotiation, shippers were able to secure lower contract rates and capitalize on favorable market conditions.

Spot Rate to Contract Rate Spread

The SONAR RATES ticker helps stakeholders monitor the spread between spot and contract rates, providing insights into market dynamics and enabling more informed contract negotiations.



Looking at the chart above, when the spread is positive (above the zero line) spot rates are more expensive than contract rates indicating tighter market conditions. When the spread is negative (below the zero line) spot rates are less expensive than contract rates indicating looser market conditions. Historically, spot rates tend to be lower than contract rates due to the higher volume of freight and greater carrier capacity in the contract market. However, an excessively negative spot-contract spread signals excess market capacity or insufficient demand.

Why Would a Shipper Use Spot Rates?

- **Primary carrier declines:** When a shipper's primary carrier is unable or unwilling to accept a contracted load, the spot market and subsequently spot rates provide an alternative to ensure timely delivery
- **Urgent shipments:** For time-sensitive shipments that may not have been planned in the shipper's forecasted contracted volume, spot rates can offer the flexibility needed to secure immediate capacity without being bound by pre-existing contract terms.
- **Low volumes or short-term project shipments:** For shippers with inconsistent or low-volume freight needs or those undertaking short-term projects, spot rates can be more economical than committing to long-term contracts.

SONAR tools such as MD (Market Dashboard) and NTI (National Truckload Index) provide real-time visibility into spot rate trends, enabling shippers to make quick, data-driven decisions when primary providers decline or urgent shipments arise.

How Can Shippers Optimize the Use of Spot Rates?

- **Market timing:** By leveraging tools like SONAR's Market Dashboard and the RATES ticker, shippers can pinpoint the best times to use spot rates based on favorable market conditions. When spot rates fall below contract rates, shippers can redirect more freight to the spot market to save costs. Conversely, when spot rates exceed contract rates, shippers should closely monitor service levels on critical lanes where contract rates may be less advantageous than spot rates.
- **Rate benchmarks:** Shippers can compare current spot rates against historical data using the National Truckload Index (NTI). This comparison helps identify trends and predict future rate movements. By benchmarking current rates against historical trends, shippers gain insights into market behavior and can make proactive decisions. This approach aids in forecasting rate fluctuations and planning logistics strategies that align with cost efficiency and market conditions.

How Shippers Can Utilize Contract Rates for Stability

- **Long-term planning:** Contract rates provide stability for long-term planning and budgeting. SONAR's VCRPM (Van Contract Rate Per Mile) offers insights into market pricing for contract rates and the trend (direction) of these rates, assisting in strategic planning and cost management.
- **Risk mitigation:** By locking in rates, shippers can start to mitigate the risk of price volatility and ensure consistent capacity for their transportation needs.
- **Carrier relationships:** Strong relationships with carriers through longer term contract agreements can result in prioritized service and better overall reliability.

Conclusion

Balancing spot and contract rates is a strategic imperative for shippers, brokers, 3PLs and carriers. By leveraging SONAR's comprehensive suite of tools and data—Market Dashboard, Market Dashboard+, NTI, VCRPM and RATES—stakeholders can gain real-time insights into market conditions, optimize their rate strategies and make data-driven decisions to enhance operational efficiency and cost-effectiveness. Understanding the interplay between spot and contract rates allows for more agile and informed responses to market changes, helping to create a competitive advantage and improved service reliability.

Learn more about how SONAR can improve your operations or **request a demo here.**