

Logistics Procurement Strategy

Logistics Procurement

Problem Statement

- “RFQ Machine” reputation
- **Go beyond “price” for LSP selection**
 - *Total Cost of Ownership*
 - *Assurance of Supply*
- Strategy partnership ad hoc in specific sub-regions and lane segments
- Business awards by ordinary RFQ’s and selection criteria reveals post hoc risks

Logistics Procurement

Logistics Procurement Strategy:

Why/where/when submitting traditional RFQ's: "Commodity lanes"

- Why/where/when considering strategic partnership: **"Solution based lanes"**
- Consistent Total Cost of Ownership weighting/selection criteria
- Due diligence process
- Global leverage

Commodity vs. Solution based Lanes

The type affects the RFQ frequency and the contractual agreement

Lane type	Lane Characteristics	RFQ frequency	Contracts
Commodity	<ul style="list-style-type: none"> • Easy shifting from supplier to supplier (< 2 wks onboarding)* • Easy to operate • No high service level and complex requirements • Provides the opportunity for reverse auction • Highly volatile and diverse rates with multiple competing LSPs • Price elasticity (on volume, service etc.) • Small value differentiation among suppliers, regarding how may they are • A lane that doesn't need solution development 	<ul style="list-style-type: none"> • Traditional RFQs with easily shifting suppliers will be as frequent as possible. Only constraint is the ability to onboard LSPs • Reverse Actions will be only with selected & proven incumbents, may not be so frequent 	<ul style="list-style-type: none"> • Normal GLAs • Rates of shorter duration
Non-Commodity	<ul style="list-style-type: none"> • Not a commodity lane (see above) <ul style="list-style-type: none"> • Difficult to shift from supplier to supplier because of IT and other system constraints • Not developed for HP's business requirements. HP needs solutions • Part of a broader strategic initiative like an E2E strategy or a specific SC design <ul style="list-style-type: none"> • Even if the lane by itself is a "commodity" lane, in an E2E design the least commoditized part of the design defines the partner selection e.g. E2E in Australia 	<p>Medium to long -term contracts with short term RFQs with prior involvement or limited RFQs for items outside partnership</p>	<p>Normal GLAs plus contract clauses, processes & agreements to ensure partner competitiveness without stressing the relationship (e.g. agreement on inflation index)</p>

How to go beyond price

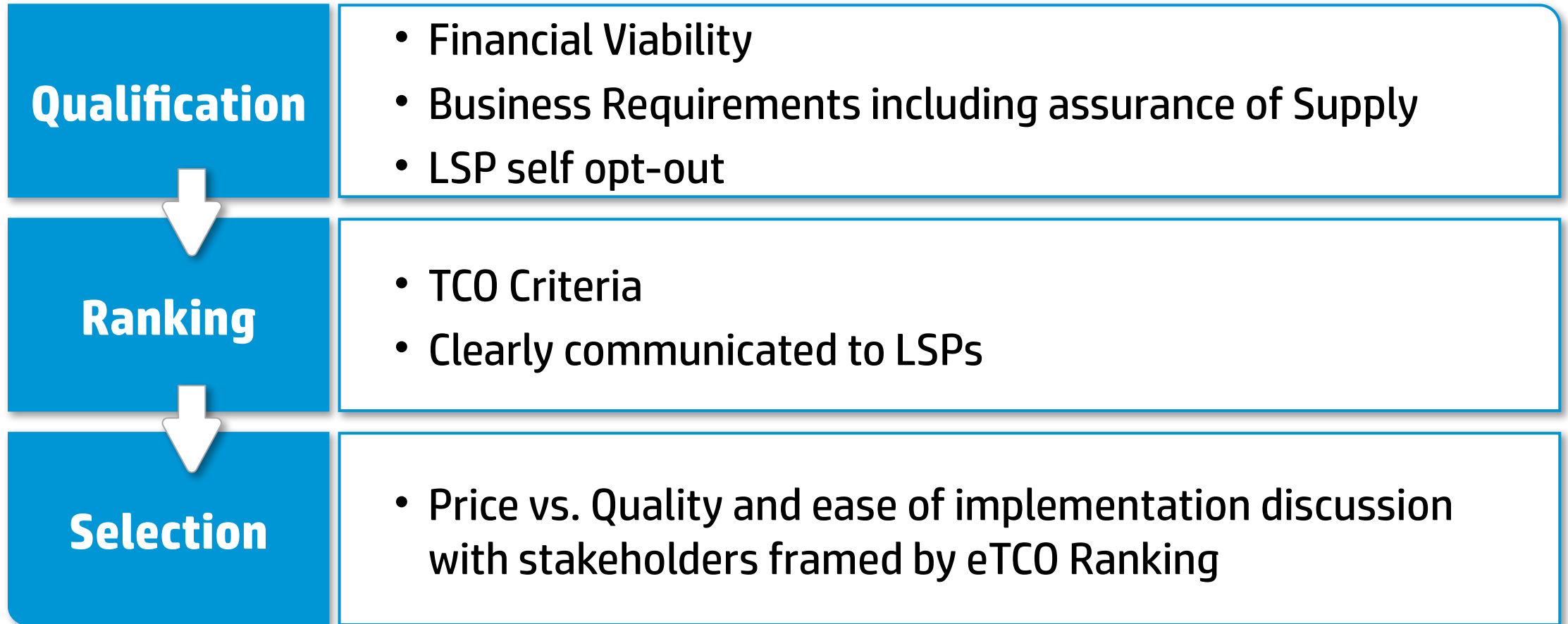
Problem statement

- Total Cost of Ownership (TCO) is a potential method: The quoted price is taken as the starting point and then cost is added considering other quality, procurement and operational issues. The business is awarded to the supplier with the lowest total cost. The output of pure TCO is cost.
- TCO provides essential information for LSP evaluation and selection purposes. However, experience from attempting to apply a simple “formula” TCO exposed shortcomings. We structure and propose a solution enhancing TCO for avoiding these inherent shortcomings

Proposed Solution with *eTCO*

1. Use the TCO concept to objectively select and evaluate costs, quality and environmental considerations associated with the entire logistics purchasing cycle
2. Utilize an efficiency benchmarking method to rank LSPs using the selected TCO factors as inputs and the corresponding purchased services as outputs
3. We call this approach ***eTCO***. The output of eTCO is a ranked list

Partner Selection Process: Top Level



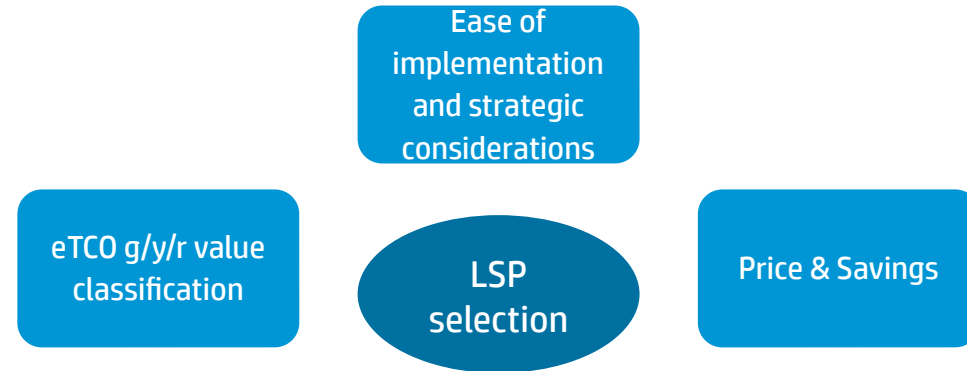
TCO ranking criteria

AIR & OCEAN RFQ implementations

TCO Factor	RFQ Scope
On-Boarding time	By LSP, award segment/Origin, Destination Region
TAT (gross & net)	Overall WW, cross-modal (not only for air) by LSP
POD timeliness (2 days)	
Missing & Damaged (HW & Supplies)	
Global Evaluation Score	

An e-TCO driven partner selection framework

- eTCO is used to measure and classify the value proposition of each LSP based on known performance
- Selection based on aligned perspective comprised of
 - Price & savings
 - Value proposition
 - Strategic considerations and risk



Example framework implementation

Origin Reg	Dest Regi	Award Segment	IDS	Incumbent			Best Price LSP				Best eTCO LSP			Other high eTCO LSPs
				LSP	Price	eTCO clas	LSP	Price	Savings	eTCO clas	LSP	Price	Delta	LSP Price(delta)
APJ	APJ	AP-AU	No	Schenker	\$14.84M	2	DHL	\$13.39M	\$1.45M	2	Nippon	\$15.08M	\$0.24M	KWE \$19.53M(\$4.69M); UPS \$19.46M(\$4.62M);
APJ	APJ	AP-CN	No	Schenker	\$2.40M	2	KWE	\$2.04M	\$0.36M	3	Nippon	\$3.08M	\$0.69M	UPS \$4.41M(\$2.01M);
APJ	APJ	AP-HK	No	Nippon	\$1.84M	3	KWE	\$1.64M	\$0.20M	3	Nippon	\$1.84M		UPS \$4.15M(\$2.31M);
APJ	APJ	AP-ID	No	KWE	\$0.20M	3	KWE	\$0.20M		3	Nippon	\$0.27M	\$0.06M	UPS \$0.23M(\$0.03M);
APJ	APJ	AP-IN	No	Schenker	\$13.37M	2	DHL	\$12.18M	\$1.19M	2	Nippon	\$17.59M	\$4.22M	KWE \$12.78M(-\$0.59M); UPS \$18.84M(\$5.48M);
APJ	APJ	AP-JP	No	Nippon	\$4.04M	3	Nippon	\$4.04M		3	Nippon	\$4.04M		KWE \$5.22M(\$1.17M); UPS \$8.07M(\$4.02M);

eTCO Ranking algorithm

Generic, not specific to air-RFQ

Description

- For each TCO factor and each LSP, measure as a percent how close the LSP is to the best performer
- For each LSP take the weighted average (if given a set of weights) across all TCO factors
 - Required weights should be decided prior to performing ranking
 - For the air-RFQ the weights are all equal
- Rank all LSPs

Requirement

- Inputs need to be all normalized in regards the corresponding outputs

Data	d1	d2	d3
Price	1	4	6
OB	3	2	1
LTAT	1	2	7
M&D	2	5	10
Corresponding Output	1	3	5

Not equal outputs.
Need to Normalize

Not needed for the air-RFQ as the comparison is done by award segment and equal Kgs



Normalized Data	d1	d2	d3
Price	1.0	1.3	1.2
OB	3.0	0.7	0.2
LTAT	1.0	0.7	1.4
M&D	2.0	1.7	2.0

After normalization (divide Data by the corresponding Output)

In **bold** the minimums

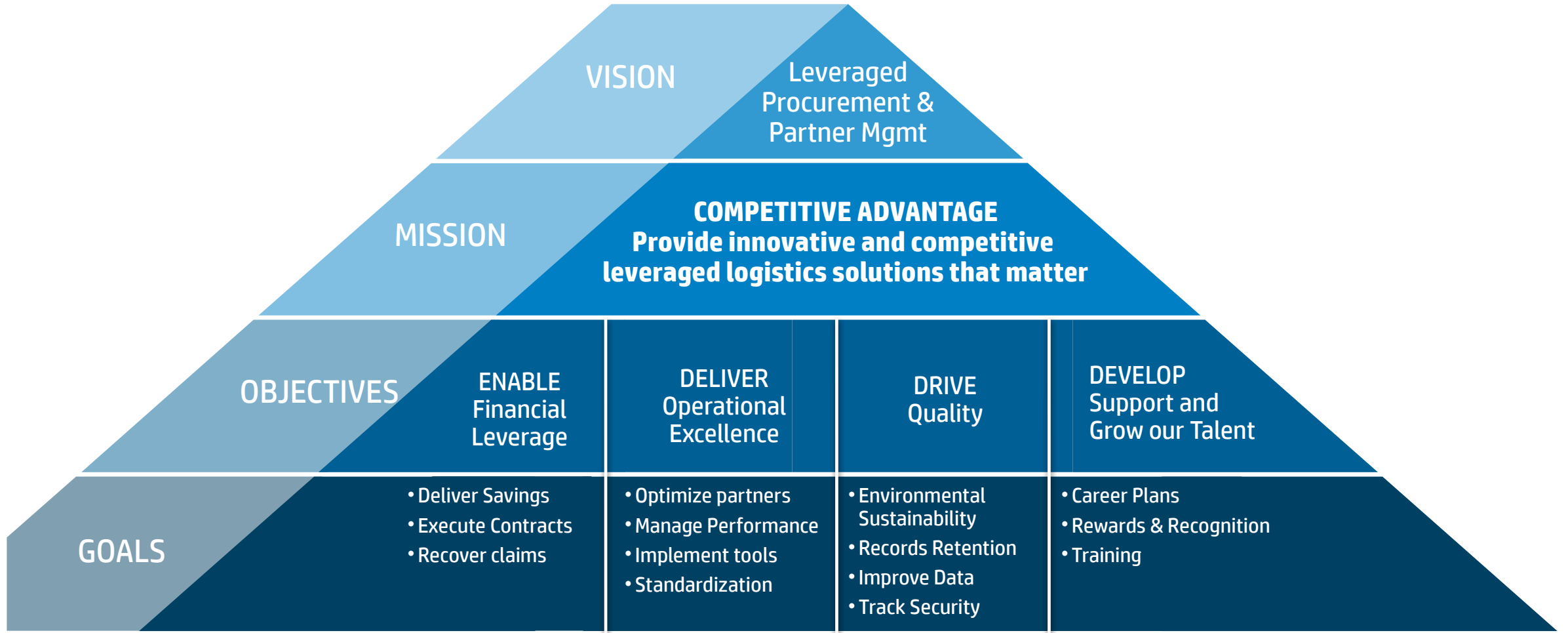


% of minimum	d1	d2	d3	Weights
Price	100%	75%	83%	40%
OB	7%	30%	100%	15%
LTAT	67%	100%	48%	15%
M&D	83%	100%	83%	10%



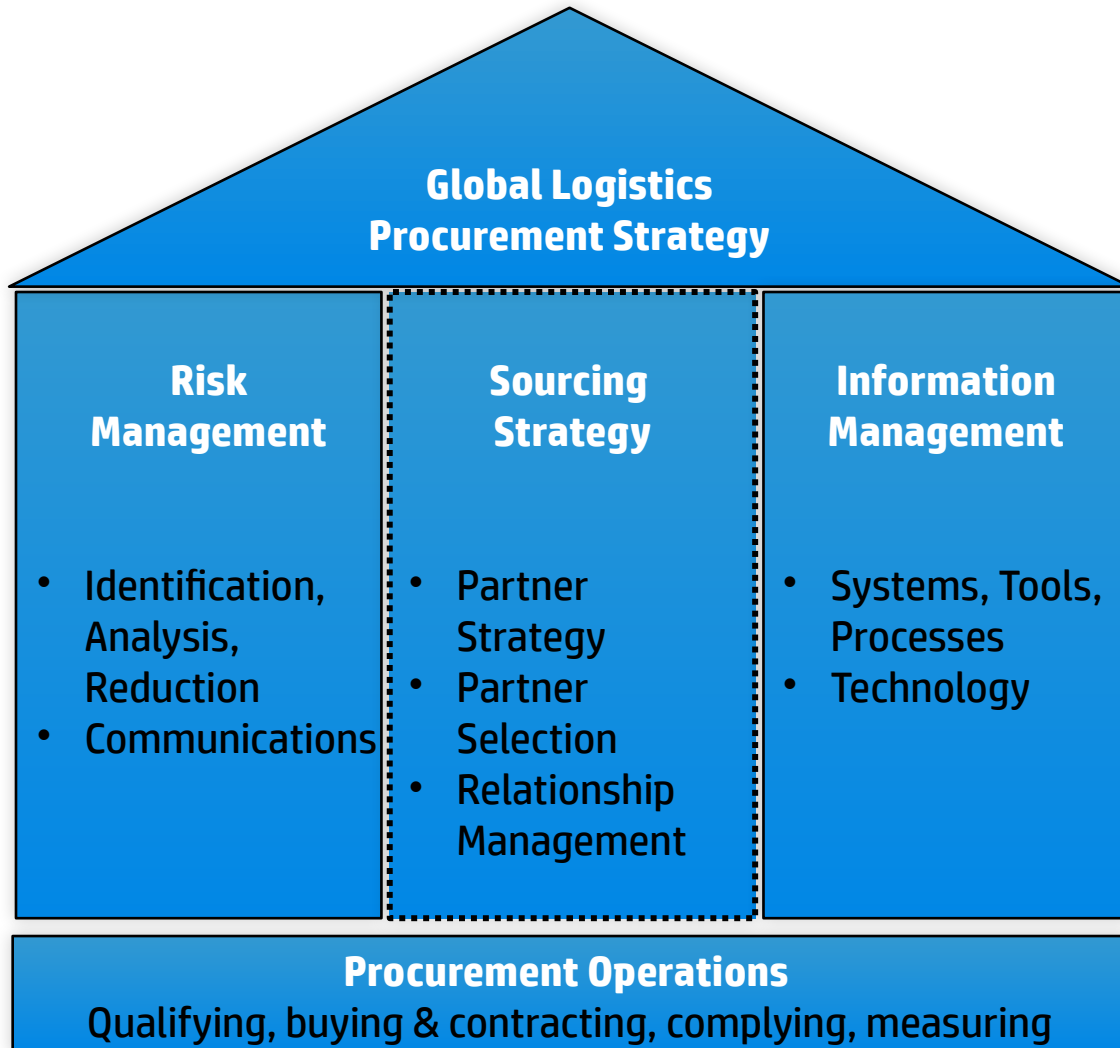
Weighted avg	D1 (Third)	D2 (Second)	D3 (First)
e-TCO	59.3%	59.5%	63.8%

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Timeless imperatives



Sourcing Strategy requires identification of **supplier relationship type** and corresponding relationship structure

Strategic Sourcing & Supplier Relationships

Relationship typology¹

Relationship		Characteristics					
		Proximity	Visibility	Interaction with competitors	Communication	Culture	
Global / Regional	Commodity	Buy on the market	Arm's length. Transactional pricing through short lead time RFQ with limited prior involvement	Technical requirements of purchase	Significant	Computerized interaction	Not an issue
	Strategic Sourcing	Ongoing relationship	Medium-term contracts with short term RFQ and prior involvement	Some sharing of goals and tactics	Some	Through designated contact points such as account managers	Awareness of culture
		Partnership	Long-term contracts. Limited RFQs for items outside partnership.	Full sharing of goals, strategies and tactics	Limited	Increased interaction between related departments; some degree of trust	Awareness and adaptation to each other's culture
		Innovator	Collaboration/ strategic alliance	Long-term relationships. No RFQs	Full sharing of goals, strategies, tactics and attempt to reflect partner's plan in their own	Limited or none	Extensive communication; high level of trust; enforced via contracts and licensing
	Mergers and acquisitions	Ownership	Full sharing of goals, strategies, tactics as internal commonly held information	none	Varies	One culture	

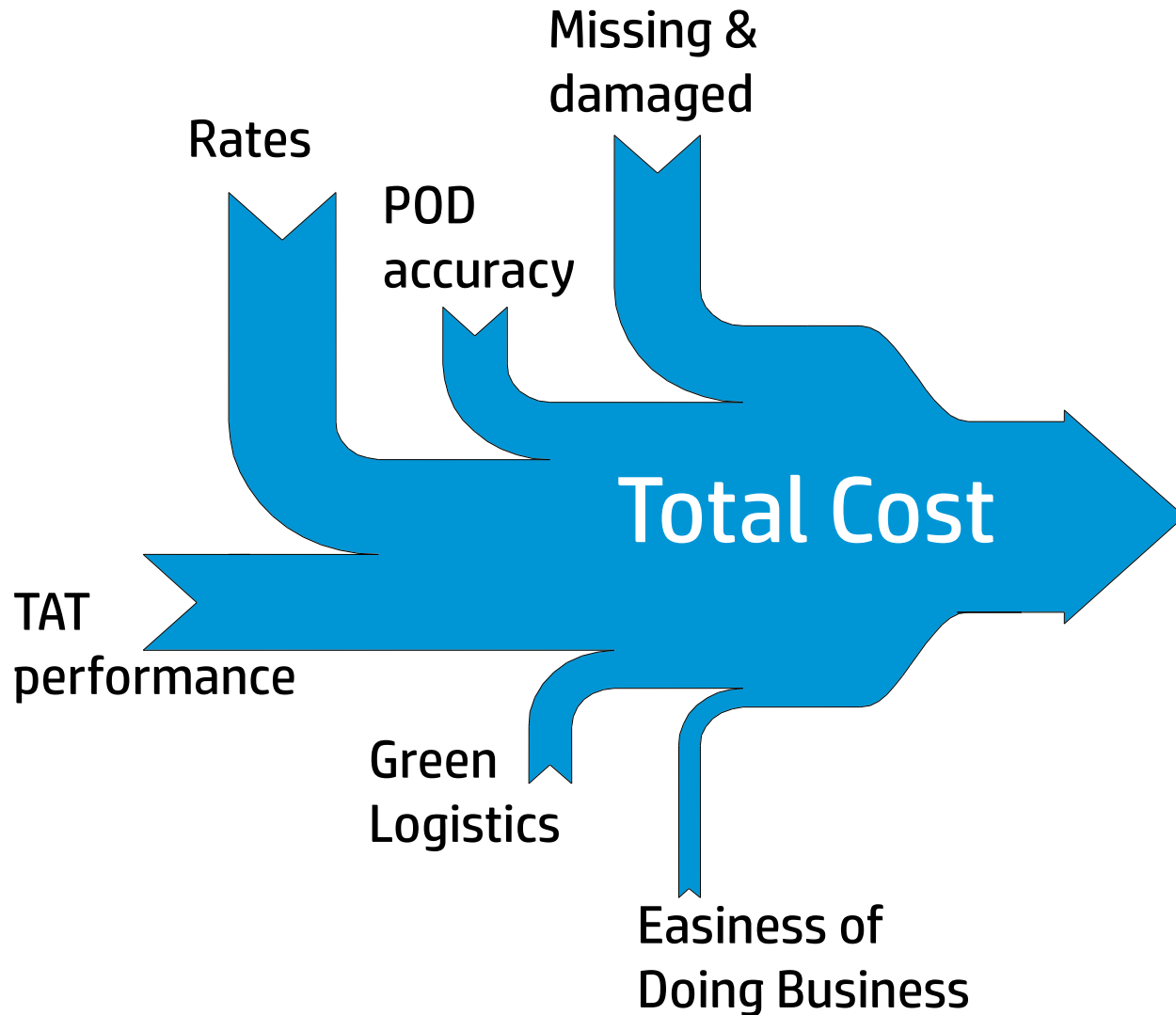
1. Based on APICS CSCP v2007

Strategic Sourcing & Supplier Relationships

Relationship choice points and factors to consider

Risks and Benefits	Benefits to buyer	Risks to Buyer	Benefits to Supplier	Risks to Supplier
<p>“Strategic Alliances” – Solution Space</p>	<ul style="list-style-type: none"> •Reduced total cost •Increased quality •Faster response •Enhanced new lane and modes development with supplier involvement •Highly skilled supplier base •Fewer suppliers to manage 	<ul style="list-style-type: none"> •Increased transactions cost pre supplier •Supplier becomes monopolistic, less responsive 	<ul style="list-style-type: none"> •Locks the business. Revenue retention •Ability to increase skill •Ability to make long term investments •Higher margins 	<ul style="list-style-type: none"> •Limited opportunities for new business, particularly with alliance partner’s competitors •Capacity locked up by partner
<p>“Buying the market” – RFQs Space</p>	<ul style="list-style-type: none"> •Decreased unit cost •Decreased transactions and processing cost •Faster response 	<ul style="list-style-type: none"> •Decreased quality •Loose Service •De-skilled supplier base •Fewer suppliers over long term •Alienate suppliers 	<ul style="list-style-type: none"> •Access to new business •Use excess capacity •Knowledge of winning bid 	<ul style="list-style-type: none"> •Lower margins •Decreased ability to invest in improvements •Startup cost for new software •Buyers use information to generate bids

Total Cost considerations for Strategic Alliances



- e-TCO method objectively ranks suppliers
- Embedded ranking in selection process