SCS 3PL Inventory accuracy proposition

Do it yourself

Your Technology
Your Process Management tools
Your operational model

\+

Your staff
(Pay 100%)

=

Get 96-98% net
inventory accuracy

The relationship between a **labour cost** and a **KPI** outcome is called the “**Cost/KPI correlation**”

SCS Standard Rates

Our Technology
Our Process Management tools
Our operational model

\+

Our staff
(Pay 80%)

=

Get 99.7% net
inventory accuracy

Pay less – get more!
…this is the deal,
the best “Cost/KPI correlation” value

(note: there is still an error rate but it is significantly reduced)

SCS Special rates

Our Technology
Our Process Management tools
Our operational model

\+

Our staff
(Pay 160%)

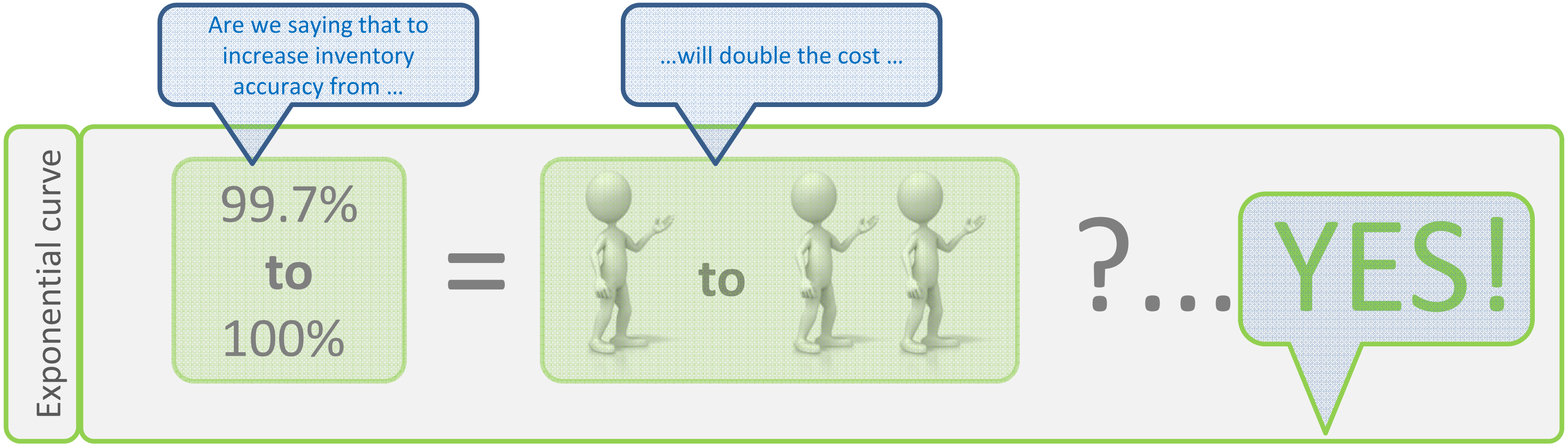
=

Get 100% net
inventory accuracy

Beyond a “cost/kpi correlation” threshold there is

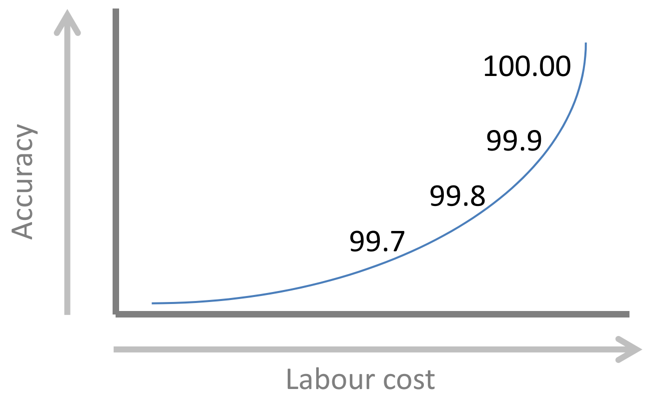
a) An exponential curve cost impact (page 2)
a) A materiality threshold argument (page 3)

SCS 3PL Inventory accuracy proposition



Once you have applied the best of your process management tools, technology and know how IP you are left with a performance metric. We define that metric at SCS as **99.7%** as an average (it changes by account depending on different factors) we claim our metrics to be the highest in our industry we then couple this metric with the lowest rates (at a total cost of ownership level). To improve beyond this point you incur a disproportionate increase in related cost.

For example with ethical drugs and restricted pharmaceutical goods we apply 2X the process management to guarantee 100% but this means the price increase two fold. The scientific term for this is a normal distribution but the key point here is that there is a direct relationship between a rate you pay and a KPI we can deliver. In simple accounting terms it is referred to as a materiality threshold which we'll discuss on the next page.



When is enough accuracy … enough?

What accuracy can I afford?

What is commercially viable?

How do I manage the risk of not being perfect?

What's reasonable?

Materiality Threshold

The point at which it no longer makes economic sense to keep spending time and money to get a perfect outcome

A **materiality threshold** is an accounting term where the bean counters discovered there comes a point that if you keep spending time and money trying to get a perfect outcome you are soon flushing hard earned money down the toilet. So you stop – this loss is known as a 'commercial risk'.

Would you spend 3 hours investigating an accounting entry to get it to balance when the imbalance is worth 20.00?

Would you spend NZD1600.00 to find an inventory item worth NZD50.00?

Would you spend NZD 50.00 to return a broken toaster that is worth NZD5.75 landed?

If you answered no to the three questions above then you understand what a materiality threshold is, if you answered yes then we recommend that you don't outsource on standard rates and either make sure you request special rates and be prepared to pay for what you expect or go the futile path of managing this function yourself (and come back to us when you eventually get it ☺).

If you said no then lets move on and discuss how we deal with the imbalance on the next page as this addresses the commercial risk element of an accuracy metric.

With so many branching options and with so much variability within an option its easy to see this becomes a complex issue, the cost could be minor or it could be significant. The biggest problem is that no one knows what the eventual outcome of an error will be what we can tell you is that 0.3% creates a lot less problems than 2% so at least you've mitigated a huge amount of risk already by partnering with SCS!

Commercial Risk

An inherent risk in running your business.
Most clients end up accepting say 99.7% but this still leaves the possibility of a 0.3% error rate. Lets look at what that is and how to mitigate the problems it can create.

What we do know

1) We can manage the risk by paying for much more process management
    1) Currently
        1) we double check inwards and outwards
        2) We single check transfers
        3) We employ a stock checking methodology

        All this is wrapt up in the standard rates
    2) We could and can
        1) Add a third high level supervisor check to all inwards and Outwards
        2) Add a second supervisor check on transfers
        3) Use more process intensive stock checking methodologies
2) Accept the 0.3% as a commercial risk and cost of doing business (all the big companies do this), or
3) Insure the risk.

Risk Insurance

You can lock down and control any risk in your warehouse Solution – but there is always cost – somewhere.

The small % where things go wrong is called 'ullage' in the 3PL industry.

Ullage is how we define the commercial risk of managing inventory.

Different industries and different companies within the same industries all deal with risk differently. E.g. One major retail chain in NZ accounts for ullage at 5% in their SLA. Despite millions of dollars of inventory management systems and process management they expect to not to be able to account for 5% of what they have bought, at stocktake time. To manage this they push the risk back to the supplier as a contractual discount, this ensures the supplier builds this into their sell pricing, by parking the issue and how to deal with it factually against the SLA as an accountable expense, not emotionally against "he said", "she said". The onus is then on the supplier to decide if he wants to keep supplying, negotiate a higher price or not supply.

There are four methods we know of to approach ullage risk insurance.

- Accept the risk as a commercial cost of doing business and don't factor it into your COGS (a lot of companies do this because at the end of the day the ullage might say be down a thousand one year and up a thousand the next and where you are getting your inventory ullage down to 0.3% the cost of mitigating it normally ends up much more than the cost of the actual ullage)
- Accept the risk as a commercial cost of doing business and factor it into COGS (incidentally, most import/distribute companies do this)
- Don't accept the risk as a commercial cost of doing business instead ask your supplier to factor it into their pricing then record the specifics in an SLA.
- Don't accept the risk as a commercial cost of doing business and **don't** ask your supplier to factor it into their rates but if an event occurs that justifies a claim on your supplier in your mind, raise one and then expect them to pay.

Please note: Our standard rates as defined by our standard SLA **does not** accept any liability for ullage. It **does** specify KPI metrics that we are prepared to be measured against and our claim is that our the relationship between the KPI metrics and the rates we offer represent the best value for money in NZ.

That said, for companies that do require the supplier to provide insurance for ullage we have two products that do just that!

Risk Insurance

You can lock down and control any risk in your warehouse Solution – but there is always cost – somewhere.

So to summarise…managing your ullage down to the smallest humanly possible % and equally affordable solution is job #1. Now, how do you decide how best to manage the remaining ullage?

You could ask your insurance company to cover it (we are not aware of any that do but you should ask your insurance agent all the same) you can build it into your COGS, you can accept it as a commercial risk and roll with the highs and lows or you can ask us.

If you ask us we have two products we can offer you.

SCS 3PL +3% and SCS 100%.

SCS +3% is a non scientific method to apply a Band-Aid on the issue, SCS simply increases the total fees by 3% and offers to cover any loss at landed cost over and above the agreed net inventory KPI metric. So if the metric was 99.7% and the total loss was 0.5% then SCS would pay the value of the 0.2% - no questions asked. The onus is then on SCS to establish if they wish to support this arrangement in perpetuity which we do through regular reviews of the commercial outcomes.

…so what happens on a standard rates agreement is SCS fails to meet the 99.7% KPI?

OK so whilst this has never happened… it could, our expectation is that you'd fire us as we'd be in clear breach of contract. This is our biggest motivation and service driver, this is why we work so hard, to ensure we never get fired. We have millions invested in technology and MHE, to loose clients because we were not performing would mean we'd be unable to support the costs we've committed to and it would end our business.

To add additional comfort, where we are offered a personal guarantee for payment (our biggest risk) then under our service agreements since 2007 it is standard practice that we reciprocally offer a service guarantee against our KPI schedule, simply put this means that if we were to materially fail to achieve the KPI standards we will move you, at our cost, from shelf to door to anywhere within Auckland, the complete text of the guarantee can be found in both our pricing proposals and our Service agreements.

As far as we are aware we are the only 3PL provider that backs our service this much and offers such a guarantee in writing and in our agreements.

Risk Insurance

You can lock down and control any risk in your warehouse Solution – but there is always cost – somewhere.

SCS 3PL 100%

This product guarantees to recover 100% of any inventory loss at a defined value (landed cost, wholesale or even full retail if you wish) Because our standard rates are structured based on the "cost/kpi correlation" in consideration to our systems IP, process management IP and know how IP it's important that you understand they discriminate based on time not inventory value or ullage insurance (which can only be calculated knowing inventory value – see below), standard rates pricing is maximised to reduce your costs. Our position in regards to ullage under a standard costs proposal is that you have made a commercial decision surrounding how you will manage your ullage risk.

You can draw an analogy here whereby an insurance company can tell you very accurately how many car accidents will occur in March, but they cant tell you who will have the accidents, likewise we can tell you we can manage the ullage down to 0.3% but we cant tell you what or where that error will occur, so many of our processes still rely on humans and to err is human.

Put another way, if the cost to pick a carton is 10.00 and the wholesale value of the carton is 100.00, 1,000.00 or 10,000.00 our picking cost does not change. We aim to make a 5% net operating profit, a typical importing business model will aim to make a 10% net operating profit. So if we make 50 cents out of our 10.00 then our clients will make 10.00, 100.00 and 1000.00 respectively on the same transaction. We don't charge more because the value of the goods is more.

To account for that sort of value risk, SCS needs to adopt the position of an insurance actuary. This is a highly mathematically based finance/risk assessment modelling role that seeks to understand the scope of the risk/exposure in relation to **your** margins and then the fees to administer the insurance and then construct a premium this can be presented back to you amortised in the rate schedule or as a stand alone insurance premium.

Whilst this is not a typical 3PL offering, SCS prides them selves on responding to all sorts of unusual client requests, we don't mind doing this and we do this for a couple of clients. If you need this please ask.

SCS 3PL Inventory accuracy proposition

Summary

Customer satisfaction is achieved when customer expectations are aligned with supplier deliverables. And the supplier delivers.

Customer delight is when the supplier exceeds the customer expectation

Our recommendations around inventory accuracy

1) Ensure you understand ullage and are clear how you want to manage it, if its with the supplier let them know so they can assess the scope of the risk and build it into their price offering.

2) Ensure you understand the difference between net and gross stock accuracy and you've done your research to know you are delighted with the offering.

3) Wrap 1) and 2) into a service agreement, then SCS can achieve our number one goal and deliver on 2) and 3)