Ullage explanation

There are three ways you can engage SCS in regards to stock accountability

Standard rates (default)	Ullage is at owners risk, Most clients engage SCS on standard rates
Standard rates plus 3% levy (on request)	This provides insurance **over** the ullage allowance
Special rates (on request)	This provides an insurance over and including all or part of the ullage

Background

Contract logistics is an environment where multiple tasks representing thousands of transactions occur concurrently managed by large numbers of people.

Companies contract 3PL suppliers like SCS to reduce costs, improve service deliverables and leverage IT innovation to increase their competitive advantage.

SCS pride ourselves on delivering excellent service however errors do happen and its best to discuss how to deal with errors up front rather than not at all or wait until a misadventure happens then deal with it.

This document therefore is designed to present the framework around how to deal with errors.

When companies perform their own warehousing functions they accepts 100% owners risk liability on stock imbalances (commercial risk) caused through inventory management error, theft or supplier packaging error.

At SCS we reduce this to, on average, between 0.1 and .5% through our specialist processes, policies, environmental management tools and trade secrets.

Exactly where this accuracy metric exists for your business is illustrated in the accuracyandlabelleing.pdf which can be found here.

This commercial risk is called ullage, it can be a contentious issue if not understood, indeed its so complex that insurance companies don't provide cover for it on your materials damage policy, because it is impossible to assess where the imbalance occurred it is impossible to manage the risk therefore the risk can't be insured therefore it is pushed back to the owner of the goods as a 'commercial risk'.

Its impossible because if there is an imbalance at stock take you cant tell if it is due to a dispatch error that happened 6 months ago, an internal stock management issue e.g. a transfer conducted 2 months ago that was not entered in the system correctly and that the stock take did not pick up this year but does the next, theft or supplier packing errors that were not identified at inwards.

In reality it is completely possible to identify the exact cause but the cost benefit of doing so will never justify it.

As an example I worked for a large multi national courier company headquartered in Dubai in 1996 and was part of a global taskforce to determine what the costs would be to increase our on time delivery standard from 98% to 100% where our global infrastructure at the time was 2Billion USD/annually, the determination of the taskforce was a) you'd never get to 100% - that's impossible and b) if you got it to say 99.00% your infrastructure costs would need to at least double and for every fractional percentage increase there was a hugely and exponentially disparate increase in infrastructure cost. E.g. 99.5% was a 3 fold increase in infrastructure cost, etc…

Accountants and auditors call this a materiality threshold, this is a global accepted accounting practice that provides a quantitative guideline which specifies the point at which it is no longer financially viable to investigate an imbalance, e.g. would you spend 100.00 to investigate a 5.00 imbalance. Or would you spend 50k per annum on a security guard to mitigate an annual imbalance that might be theft or picking errors worth 5k and 5k represents 0.3% of your sales. For accountants and auditors the materiality threshold is normally 5%.

In logistics we call our materiality threshold, ullage. For most companies globally the ullage range is between 2% and 0.5% at SCS the normal range is between 0.5% and 0.1%.

SCS claim the highest client retention rate in our industry. This is one of the reasons why.

Understanding the options

Please note when we discuss claims it is always at landed cost value, never at a value above this and never in consideration to consequential loss with the following exceptions explained under special rates.

Standard rates – these are what we present when we are asked to provide rates, they support a range of KPI's in the services agreement, labour charges are calculated based on time and storage charges are calculated based on facility and operating costs. (copy's of either cost model available on request)

In terms of labour, the standard rates do not represent a financial interest related to the value of your goods or the value of a transaction between you and your client, for example if an order takes on average 15 minutes to process, our charge will be in the region of NZD6.88 irrespective of whether the order value is 100.00 or 10,000.00.

They are time based.

Using the same logic, if we charge a rate of 3.50 per pallet per week, in a standard rates agreement we don't factor in the value of the goods on the pallet, so if it is 1,000.00 (e.g. empty plastic bins) or 26,000.00 (e.g. a pallet of alcohol) the rate is the same because the storage cost model is based on associated facility costs not a risk profile.

Our risk proposition on **standard rates** is that we are better than the Market or if you were to do it yourself and in-source the function.

Under standard rates we act as a bailee and receive a fee for service just like an employee and just like an employee we are bound to always act in good faith, unlike an employee we have the advantage of specialist systems and scale to offer clients higher accuracies, faster processing times and lower relative costs with significantly reduced HR stress.

Under a standard rates agreement, ullage is still at owners risk. SCS acts in good faith. SCS endeavors to perform better than the market, you elect to continue contracting SCS if you are happy with the service, our client retention level is at close to 100% even after 8 years, in our industry in NZ we understand this to be extraordinary.

Whilst standard rates do not specify an insurance policy we have and will from time to time make ex gratia payments without prejudice as a commercial decision as events dictate as any good business does.

Standard rates + levy (circa) 3% - under this agreement the rates are levied 3%, this provides the customer a financial surety that if our performance was to drop below our KPI we will reimburse the client for the cost of the goods where the value exceeds the KPI. For example if the KPI for stock accuracy was 99.5% and SCS delivered 99.7% then SCS would be liable for the .2%.

This is a broad insurance cover SCS provides.

We retain the right to review this annually (just like an insurance company). We may choose not to provide this or increase the levy as we may deem the product too attractive even with all of our security measures as it creates an unreasonable exposure to opportunistic theft (e.g. diamonds), inadequate packaging exposing, unreasonably exposing it to damage (e.g. could not sustain a fall from 3 feet in standard supplier packaging), suppliers are too unreliable by our standards yet the client does not want to pay for an item count on inwards and asks us to accept the supplier count as notated on the outer cartons to reduce labour processing costs or it might be Printed Material which is weigh counted and accuracies are effected by moisture in the air etc…

Special rates – these are rates that are requested over and above standard rates to recognize the financial value of an item or items to you and wanting to make SCS financially liable for including all or part of the ullage allowance. Whilst it is not standard practice to ask us for insurance over and above our standard rates it does happen from time to time and you are welcome to do so at any time, we are happy to look at this however we need the opportunity to conduct a detailed risk assessment to create a premium that fairly represents the risk.

Please note: when we offer special rates or Standard rates + levy, the risk is greater than just acting in good faith, it requires us to adopt a position of an insurance company and accept good faith is not good enough, reciprocally we always require a personal guarantees to balance the risk profile of the relationship and reflect the higher risk.

- **Complete cover**, you can ask for complete cover and we will assess and provide an insurance premium for this. This protects you against all damage or unexplained stock variances that fall within the ullage threshold (typically 0.1 and 0.5% using a standard set off method) and outside the threshold*

  The calculation is sometimes simple depending on the product attributes and risk profile we model it against, often it might be similar to the ullage % related to sales plus a contingency and admin factor of 20%, so if the sales were 3M and the ullage percentage was 0.3% then the premium would be 10,800 plus the levy.

  *Please understand this only covers ullage, all other insurances still need to be maintained between you with your insurance company e.g. theft (e.g. break-in), fire, flood, war, damage etc…as we don't own the stock or have a vested interest in it we can not provide insurance for it, if there was a claim based one of the issues stated above you would still have to claim off your insurance company, they will pay out and then in theory they would seek recovery from our insurer's.

- Ullage is different, its a commercial risk insurance companies wont insure that you can ask us to consider.

  This can be invoiced separately or built into and 'massaged' over other rates.

  General note - Most people do not bother with this and prefer to carry the risk, because ullage is + and – it's just as likely that an imbalance will be + as it is likely to be – yet a premium is always a cost. Whilst we can happily demonstrate our accuracy and our track record, you are welcome to explore the issue with SCS at any time.

- **Partial cover**, you may have just a small section of high value items you need additional insurance for, e.g. Client A sells animal pharmaceutical goods, 2% of the range represent restricted drugs (and 40% of the value) and they want SCS to provide 100% stock guarantees over selected items, SCS conducts an assessments and deems a special safe or cage is required and a higher level of process management needs to be adopted, SCS then offers a special rate to recognize the additional CAPEX, risk and management required to deliver this.

In aligning client expectation with our ability to deliver performance we're really establishing a framework for satisfaction, guaranteeing as suppliers we work well for you and paving the way forward to do so.

It is our intention to offer and deliver a service that delights.

Please note this document should be read in conjunction with the accuracyandlabelling.pdf document