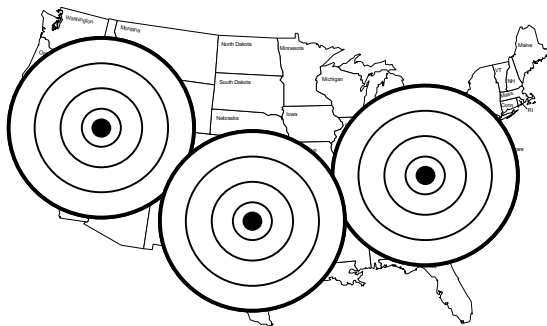


OUTSOURCING

HOW TO SELECT A THIRD PARTY OPERATOR

The selection of a third party warehouse operator should be conducted through a research process with the accumulated information base resulting in a clear choice. The process, which is outlined below, utilizes just such a format.

- Collection of background information to define the market, services required, and general scope of work
- Development of capabilities requirements and solicitation of responses from potential third party alternatives
- Evaluation of alternatives response of capabilities
- On-site evaluation of finalist capabilities
- Selection



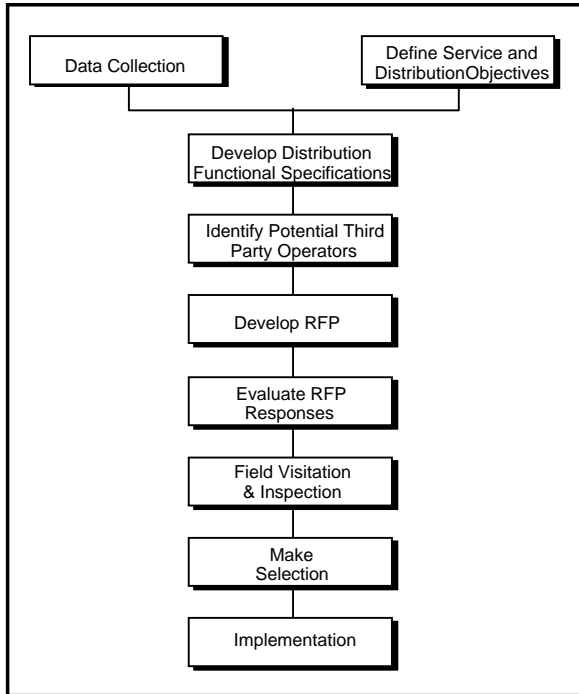
The first step in this process is the collection of information within your organization to define the specific market, services required, and the general scope of work which you would expect a third party warehouse to perform for you. Data collection should include your assembling basic information such as product characteristics, anticipated volumes, method of receipt of inbound transportation, packaging, receiving sortation, receiving inspection expectations, cubic dimensions, weight, volume, perishability, breakage, seasonality, and other characteristics of your organizations inbound product. Similarly, you must assemble the same characteristics of orders that will be received, quantity of orders received on a daily, weekly, monthly basis, any

seasonality of order receipt, method in which orders will be transmitted, and format in which they will be received. Additionally, you will need to gather typical order characteristics, i.e. the number of lines per order, the number of items per line, typical size of a completed order both in weight, cubic volume, and other pertinent specifics. Thirdly, data must be collected on individual shipments that will be made on the outbound. Will they be partial shipments? Will they be LTL shipments? Will they be full truckload shipments? Who will determine the carrier? Who will conduct rate negotiations? Who will handle freight payment, transportation management? What is the expected order cycle time, shipment time, and what are other service characteristic requirements? What will be the quantities of orders to be received processed and shipped out on a daily, weekly, monthly basis? Is there any seasonality of such activity i.e. monthly peaks, and/or shipping peaks in particular months of the year? What are the characteristics of orders? Are there specific labeling requirements, bill of lading requirements, manifest requirements, etc.? Finally, data needs to be assembled regarding assessorial services to be performed. These may include special packaging, labeling, price tagging, shrink-wrapping, re-packaging, over-packing, special inventories, cycle counts, special export documentation, management reports, and/or any other extra services.

Once the data has been developed a clear understanding must exist within you organization regarding specific objectives, which you expect this third party warehousing relationship to provide. These objectives should include your desired trade-off between service, price, and/or other potential variables. These objectives should be clearly stated and should represent management strategic, as well as tactical, expectations for this relationship between your organization and a third party warehouse operator. After you have compiled the above information, you are now prepared to begin to assemble a list of potential third logistics and/or third party warehouse operators who could be expected to perform the services that have been outlined. There are a number of directories available, as well as

associations, that can be utilized as a starting point. Unfortunately, all too often these sources are incomplete. It is often best to enlist the assistance of people familiar with the third party marketplace. These could be within your own organization or other professionals with whom you are involved through associations. In many cases, it may be necessary to engage a logistics consultant who has specific expertise in this area.

The following graphic overviews the process which is outlined in this article:



Upon identifying potential third party operators, the next step is the development of a Request for Proposal (RFP). The RFP should be based upon the scope of work previously developed. This Request for Proposal should be submitted to the list of potential third party operators allowing a reasonable period of time for them to respond to the request. Responses should be in a pre-determined format. This format should be easy for you to use in your evaluation process keeping in mind that this is an initial screening of the third party warehouse operators. The evaluation criteria that follow could be used for such an initial screening of Request For Proposals.

Evaluation Criteria

Prior to the submission of your RFP to prospective third party warehouse operators, it is best to have

established the specific items that will be evaluated, your expectations, and how each item will be weighted.

Evaluation Criteria	Third Party "A"	Third Party "B"	Third Party "C"
Service And Customer Satisfaction			
Experience with Similar Business			
Flexibility & Future Opportunities			
Total Operating Costs			
Ability to Improve Service to Distributors			
Location, Physical Facilities & Operating Procedures			

The above process allows for a scientific approach, which considers the defined scope of work and the third party operator's capability to perform it. In most cases this process requires the assistance of someone familiar with your operation and someone who has expertise in the warehouse and logistics arena. Ideally, this person should also have a strong familiarity with third party practices and third party operators. In many organizations this person will be located in the logistics department of your own organization. In other cases, it will be necessary to engage an outside consultant who has these skills.

After using this process there should be a clear indication who the single best third party operator is or who the top two operators are. At this point, and only at this point, should we begin the process of evaluating the price into the selection process. Up until this point the pricing of services has been included, but it has been only one of the decision criteria points. The negotiation process then follows between the selected third party operator or the two top selected third party operators and your organization to arrive at a mutually acceptable contract spelling out the scope of work, the expectations, the remedies in the event the expectations are not realized, charges, payment terms, and other particulars associated with a, hopefully, long term mutually satisfying relationship.

PROS AND CONS

The decision on whether or not to outsource should not be too dissimilar from any other make or buy decision in the business arena. On the one hand, the option exists for you to operate your own

proprietary warehouse, or warehouses, to provide the level of service your organization requires to distribute your products. This entails the purchase or lease of real estate, the assembly of material handling equipment, organization, and its management expertise to provide the level of logistic service your organization requires.

When organizations consider outsourcing, loss of control is often felt to be inevitable. There is no reason why your organization should lose control. Third party's management control along with your own organization's ongoing management attention should actually improve your control. A second misconception is that once your organization has outsourced its warehousing it is no longer involved in, or responsible for, its management and that all of your organization's time and cost of such management functions can be eliminated.



On the other hand, to outsource this service would allow the capital not invested in real estate or material handling equipment, or the credit not utilized in leasing real estate and material handling equipment, to be used elsewhere within the business. Similarly, the exposure of having employees both at the management and labor ranks would be transferred to a third party as would some of the business risk and some of the management responsibility for these functions. Use of a third party to outsource the warehousing function therefore would allow your organization to focus more on your core competency utilizing assets for this purpose and allow a specialty organization with specific expertise in this area, namely warehousing, to provide such services for your organization. Such an arrangement is based on the point that the third party warehouse operator will make a profit above and beyond its operating costs. If in fact you can run your

proprietary operation as efficiently as the third party operator this profit will be an added cost to your business. Thus, the consideration to outsource or not should be looked at as a financial decision much as we would evaluate any purchase of service or assets considering as an alternative to make or conduct in-house versus buy or purchase and outsource. Elements of consideration to be taken into account would be the service level requirements, your ability to produce such level of operations in-house, the cost associated for you to perform these against management capability by outsourcing, the performance record of producing such level of service which the outsource operators can demonstrate and the financial arrangement to conduct such service on an outsourced basis.

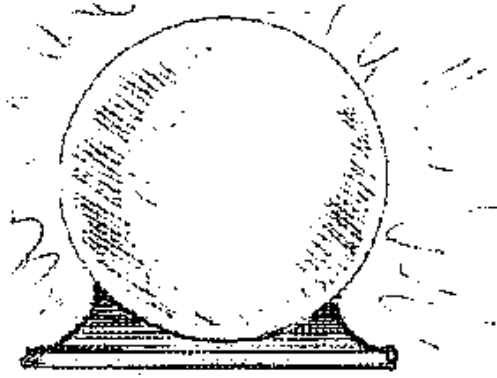
CONTRACT

As with any significant long term business relationship a formal contract is critical. Often the individuals initially involved in putting together such a relationship, "move on", they are promoted, transferred or retire. Without a well-detailed agreement those that follow may have a totally different set of expectations and understanding of the arrangement than was intended. Any such agreement at a minimum must address:

- Scope of Work
- Damages
- Individuals Status
- Responsibilities Risk & Reward
- Remedies
- Extra Services
- Termination
- Agreement Modification
- Liabilities
- Limitations
- Compensation
- Insurance
- Rate Adjustments
- Service Expectations

FUTURE

The future of third party warehousing and third party logistics in total will undoubtedly be a result of the marketplace.



The future of third party warehousing and third party logistics in total will undoubtedly be a result of the marketplace. And just as the marketplace is defining logistics requirements so is logistics helping to define the market's direction. As logistics skills and capabilities improve service expectations also rise. As the services available, the accuracy of deliveries and information transfers, speed, inventory velocity, and other products of the logistics system improve so do higher expectations. In many organizations such higher expectations can best be met by the use of third parties. A continuation of the trend to outsource will undoubtedly result in still more organizations looking at third party warehousing and other logistics functions. At the same time, though, this effort towards outsourcing non-core businesses will cause organizations that have previously felt that their core competency centered on manufacturing to re-examine the market, product, and marketplace in which they compete. This may cause them to find that the competitive opportunity, the opportunity for differential advantage may not result from the product they produce, but rather from their service and inventory capabilities. Thus, this may well cause them to consider outsourcing their manufacturing functions and bringing in-house their logistics functions.

Certainly never before has the logistics industry had the attention that it is currently receiving, nor the number of people graduating from universities educated in the field of logistics, nor the number of logisticians in the marketplace, nor the number of major corporations seeking logistics excellence, nor the number of third parties offering to provide such outsourced logistics activities, nor the expectations which the marketplace now holds. A decade ago one and two week order cycles were very common. A decade from now those same order cycle expectations will be 24 to 72 hours. A decade ago 95% and 97% order fill was considered good. A decade from now anything

less than 100% will be unacceptable. While expectations such as speed and accuracy will increase, those same expectations are that cost must either remain the same or decline. Third party warehousing need not only meet these expectations, but also exceed them. In order for third party operators to continue to grow and be competitive they must demonstrate a clear advantage or economy of scale associated with their size. Users are looking for logistics expertise, improved service, and lower cost, not outsourced warehousing for the sake of outsourcing. The future of third party warehousing is very promising. The growth that has been experienced in the last ten years is very encouraging.

ABOUT THE AUTHOR

Thomas L. Freese is principal of Freese & Associates, Inc., a management and logistics consulting firm in Chagrin Falls, Ohio. Mr. Freese received his B.S. in business administration and marketing, and an M.B.A. with a concentration in business logistics, from The Ohio State University.

His outsourcing experience is quite extensive working with the providers and the users of such services. He has prepared marketing plans, audited operations and developed in-house training programs for a number of today's largest third party providers. He has conducted strategic evaluations examining outsourcing fit for his clients. He has conducted outsourcing selections, negotiations and worked with both parties in start-ups and ongoing relationships.

Mr. Freese's consulting clients include: AAA, Ames Department Stores, Black & Decker, Bradlees, FTD, Intel, Mead, Procter & Gamble, J.M. Smucker, Perdue Farms, US Postal Service, Tupperware and Sterling Drug.

Before establishing Freese & Associates, Inc., he served as Manager of Physical Distribution for Parker-Hannifin Corporation, and in numerous line and staff distribution positions for Unocal. He is an active member of the Association of Transportation Law, Logistics and Policy (ATLLP), the Council of Logistics Management (CLM), the International Customer Service Association (ICSA), and The Warehousing Education and Research Council (WERC). He is a frequent speaker at professional conferences and seminars and has contributed articles to the *Journal of Business Logistics*, *Inbound Logistics*, *Outsourced Logistics Report*, *Traffic Management*, *Food Business*, *Distribution Center Management*, and *Warehousing Management*.