Manufacturer & Distributor Customer Pick-Up/Backhaul Fairness Statement

FMI/GMA Joint Industry Recommendations

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FOOD MARKETING INSTITUTE

GMA GROCERY MANUFACTURERS OF AMERICA

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Subcommittee:

PEPSICO BEVERAGES & FOODS

Dennis Donelon	Director – Customer Services
Patrick Carr	Senior Manager – Logistics Integration
Wayne Skinner	Director – Transportation

AHOLD USA

Joe Kouten	Director – Ahold Inbound Logistics
Gene Vaughn	Director – Supply Chain Management
Mike Scott	Vice President – Logistics

Contributing GMA Members:

Kraft Foods, Inc., The Procter & Gamble Company, Welch Foods Inc., Nestlé USA, The Dial Corporation, General Mills, Inc., PepsiCo Beverages & Foods, Diamond of California, S.C. Johnson & Son, Inc.

Contributing FMI Members:

Ahold USA, Hannaford Brothers Company, Wegmans Food Markets, Hy-Vee, Meijer Inc., Brookshire Grocery Company, Publix Supermarkets

INTRODUCTION

Despite the diligent work of past industry committees, a great deal of confusion and anxiety still exists regarding customer pick-up and backhaul agreements. The issue was frequently mentioned in interviews conducted to prepare the 2002 Supply Chain Effectiveness Survey published by Food Marketing Institute (FMI), Grocery Manufacturers of America (GMA) and Food Distributors International (FDI).

During the survey process, both suppliers and customers expressed a concern about the lack of trust and effectiveness in many backhaul program relationships. In fact, both parties believe collaboration in this area lags well behind other areas of overall supplier/customer relationships. To help solve this problem, several manufacturers and distributors suggested creating a **"Customer Pick-Up/Backhaul Fairness Agreement" (hereinafter referred to as CPU or CPU/Backhaul)**.

Today, it is generally accepted that the majority of suppliers and customers would prefer to use their own transportation carriers in order to reduce costs and optimize service within their company. At the same time, both suppliers and their customers agree that greater collaboration regarding CPU/Backhaul programs could yield significant supply chain cost savings.

The purpose of this document is to provide recommendations for opening up and improving communications between trading partners on the issue of CPU/Backhaul allowances. In doing so, we hope to provide a platform for suppliers and their customers to use best practices that can help reduce costs and improve service for all parties.

Keep in mind that this document is simply intended to provide suggestions for improving communications and planning, and is not meant to mandate new requirements for suppliers/customers in their respective logistics practices.

1. MANAGING THE SUPPLIER/ CUSTOMER RELATIONSHIP

Build Trust Between the Supplier and the Customer

Before any meaningful changes to the current supply chain management system can take place, both parties must commit to using a consistent communication strategy when approaching CPU/Backhaul agreements. This communication strategy should focus on understanding each other's business objectives, expectations and challenges. For example, backhaul discussions should not be limited to a presentation of rate information, but rather should include regular discussion of transportation capabilities, needs and market issues.

Create a Joint Team

Management of the backhaul program should be considered within the context of the overall supplier-customer supply chain relationship, with the ultimate goal of delivering products at the lowest net-landed cost. To address this issue, both the supplier and customer should consider creating a joint team that includes a representative from the following disciplines: logistics and transportation, sales, category management and procurement.

Mutual planning and execution should incorporate all activities associated with the loading, scheduling, shipping and receiving of products in support of sales and category management. (Appendix 1 references a potential model for leveraging collaborative communication throughout all levels of the organization).

Collaboration on Logistics = Stronger Support and Replenishment Capabilities

Supplier/customer collaboration is strongly recommended in areas such as logistics and backhaul to support promotion and replenishment. Trading partners do not need to wait for CPFR to see the benefits of such collaboration – effective steps can be taken now. An effective backhaul program can ensure a smooth and consistent flow of product throughout the supply chain, from the supplier's distribution center to the customer's distribution center. It is important to remember that collaboration is not dependent upon technical solutions, but rather on the commitment of vendors and customers to develop and maintain an ongoing communication process focused on achieving increased efficiencies. Cost and performance metrics should support this communication process in order to keep the focus on business results.

Understand the Goals and Objectives of Your Trading Partner

Backhaul management and collaboration will often fall to the transportation functions of suppliers and customers. While this approach is appropriate for functional planning and execution, the communication process should encompass a broader business scope.

Transportation-related costs should be part of regular supply chain discussions to ensure consistency with mutual objectives. Where appropriate, transportation goals should be included in "top-to-top" discussions and business review sessions to ensure alignment with the total business relationship. The supplier and customer each need to keep the issue of backhaul allowances in perspective, both in terms of the financial impact and the buy-sell relationship.

Review Transportation Opportunities on a Regular Basis

As the cost of transportation is ultimately a component of "net-landed cost of goods," it is suggested that supplier and customer discuss backhaul/transportation opportunities during all business reviews. Additionally, such transportation opportunities should be reviewed prior to the launch of new products; upon any changes in supplier shipment origins and customer delivery destinations; and at the outset of any new customer-supplier relationship. This business review can serve as a catalyst for a collaborative approach to transportation.

2. ESTABLISHING BACKHAUL ALLOWANCES

Explain Costs Associated with Backhaul Allowances to Customer
Suppliers are encouraged to "un-bundle" the various supply chain cost components (transportation charges, unloading charges, drop-trailer fees, etc.) to facilitate better collaboration between supplier and customer.

It is understood that all elements described above may not be part of a supplier's CPU/Backhaul allowance. However, those elements that are included in the rate structure should be clearly identified to the customer.

If additional performance-based consideration is available, the qualification criteria and metrics should be clearly identified.

Example

(A+B+C) x Performance = Allowance

A = loading cost
B = line haul cost
C = unloading cost

*Customer performance that is considered significantly below average might warrant an allowance that is less than the published rate.

Suppliers and Customers Should Seek to Reduce *Overall* Supply Chain Costs
Because both suppliers and customers are equally challenged to achieve the lowest transportation costs for their companies, it is suggested that the industry support collaborative (open book) transportation management. In doing so, both parties can share costs and enable joint savings. "Open book" relationships are defined as those in which both parties share actual freight costs for specific lanes between a supplier and customer, including line haul, handling, fuel and other miscellaneous costs. Parties should be mindful, however, of any contractual restrictions that may apply to disclosure of confidential information regarding a carrier's rates.

Example Open Book Transportation Management

Supplier's actual delivery cost, to include accessorial costs:	$600*
Backhaul allowance offered by supplier:	$400*
Customer's actual costs to pick-up and deliver, including accessorial costs:	$400*

In this example, the customer would probably choose NOT to backhaul. However, with collaborative discussions – if a revised backhaul allowance of $500 was offered – the customer might choose to backhaul, and the result would yield a $100 savings to both the supplier and the customer.

* These rates are not intended to be a reflection of industry averages. They are meant only to demonstrate a point for consideration.

Supplier Should Consider Adopting Standard Rate Structures

Most customer computer systems support a wide variety of CPU allowance types. However, due to the diverse array of CPU allowance structures offered by suppliers, it is suggested that each supplier and customer agree on one of the following rate structures:

- **Hundredweight basis (CWT)** — Allowance based upon shipment weight.
- **Cube Basis** — Allowance based upon cubic feet of product shipped.
- **Pallet Basis** — Allowance based upon the number of full pallets of product shipped.
- **Flat Rate Per P.O.** — Allowance based upon a historical average truckload shipment that meets at least one criteria of weight, cube or pallet.
- **Percent of Invoice Basis** — Allowance based upon some percentage discount on the cost of goods.
- **LTL Bracket Basis** — Allowance based upon some portion of a full truck, whether it be weight, cube or pallets.

Because many retailers' systems cannot manage CPU allowance structures offered on a per-truck basis, it is suggested that CPU allowances should be offered instead on a purchase-order-by-purchase-order basis.

In an effort to make the allowance structure as streamlined and as fair as possible, it is also suggested that:

- CPU allowances should be provided and clearly identified to the customer as a separate "off invoice" line item.
- CPU allowance calculations should be based on the "agreed-to" order quantity, not the "shipped quantity."
- Manufacturers should consider developing the capability to offer alternating rates to recognize that a full truckload is achieved by either weight, pallet or cube. Such a system would effectively take into account the diversity of products shipped today between suppliers and customers. Providing

this capability can be achieved through systems upgrades or by using flat rates within specific customer lanes. See example below:

Example

The CPU allowance is $1.00* per hundredweight based on 42,000 lbs. This rate is predicated on an average truckload weighing 42,000 lbs., with the average transportation cost of that truckload at $420*.

From time to time, due to business agreements made between supplier and customer, an order may fall below the 42,000 lb. minimum; 37,000 lbs. for instance. The lower weight may be due to a promotion on modular pallets or pallet deals that cube out a trailer before it weighs out a trailer. In such cases, it is suggested that the supplier consider allowing the full $420 CPU rate as the allowance for this move, since it is still a full truckload and will move at the truckload rate.

*These rates are not intended to be a reflection of industry averages. They are meant only to demonstrate a point for consideration.

Fuel Surcharge Consideration

As warranted, it is suggested that fuel surcharge programs be offered by suppliers to offset temporary carrier rate increases associated with any short-term dramatic increases in the price of fuel. Suppliers should advise customers in advance of any fuel surcharge offering. It is suggested that suppliers establish fuel surcharge programs that automatically add the fuel surcharge to the CPU allowances. In instances in which a customer's system cannot accommodate a supplier-offered fuel surcharge, the supplier should allow the customer to deduct the fuel surcharge amount from the supplier invoice.

Unloading Cost Consideration

It is suggested that the cost of unloading be considered in the development of the CPU/Backhaul allowance.

Example

If the supplier's CPU allowance is $1.00* per hundredweight based on an average shipment weight of 42,000 pounds, and it costs an average of $100 to unload a 42,000 pound shipment of the supplier's goods, then the CPU allowance should be increased by $.0.24 per hundredweight ($100 / 42,000 pounds).

* These rates are not intended to be a reflection of industry averages. They are meant only to demonstrate a point for consideration.

Drop Lot Consideration

It is suggested that suppliers and customers who participate in drop lots share the savings. Appendix 2 provides a list of those items that should be considered in any CPU/Backhaul agreement.

Backhaul Discussions Should Include All Appropriate Functions

As mentioned earlier, a team approach to backhaul discussions will be important to help improve joint CPU/Backhaul arrangements. Keeping that in mind, it is suggested that the supplier and customer not conduct backhaul allowance discussions solely between the supplier's sales person and the customer's buyer. All appropriate functions should be included in backhaul allowance discussions as referenced in Section I of this paper.

More specifically, it is suggested that CPU allowances should be presented by the supplier to the customer's transportation/logistics department at the same time as other discussions are occurring between sales and procurement. Since the ultimate goal of both parties is to achieve the lowest cost to deliver goods from supplier to customer, both supplier and customer transportation representatives should be included in all joint discussions.

Any supplier considering a change in CPU allowance rates should contact the appropriate customer representative to set up a joint meeting to determine if a rate reduction is appropriate. At this same meeting, parties also should agree upon a CPU allowance structure that is fair and equitable to both parties.

Finally, it is suggested that any changes in CPU allowances or customer pick-up agreements should be communicated to the customer at least 30 days before the effective date.

Special note: *There is a strong perception within the customer community that CPU/Backhaul allowances are not readily available from suppliers. It is suggested by this committee that FMI and GMA form a subcommittee to analyze how best to enable suppliers to communicate allowances systematically. This subcommittee would also examine how to enable a customer to contact suppliers individually about such allowances using the Internet or data synchronization capabilities being developed by industry trading exchanges.*

3. MANAGING PERFORMANCE – SUPPLIER, CARRIER & CUSTOMER

Establish Joint Performance Metrics

Both manufacturers and distributors express concern that there is not enough initial communication about what is expected from all parties participating in CPU/Backhaul programs. Too often, one or both parties become frustrated because of poor performance against one or more of the following metrics:

- Pick-up performance
- Delivery performance
- Consistent participation
- Loading practices
- Equipment compliance

Such disagreement often results in additional supply chain costs and sub-optimal service for all parties. In order to improve this situation, both parties should establish mutually agreeable performance metrics that apply across the board.

Two examples of cost drivers typically resulting from lack of agreed-upon metrics include trailers not being loaded on time for the scheduled pick-up, or a trailer arriving for pick-up that does not meet specifications required to handle the entire load, thus requiring additional handling and time by the supplier. Such inconsistency makes it difficult to plan for the carrier capacity required to deliver loads on time to the customer. Additionally, this "waffling" (i.e. flipping from CPU to delivered) on pick-up loads also increases costs by forcing the manufacturer to go to the spot-market for carriers.

We believe that elevating this discussion on metrics, as well as providing ongoing feedback through the use of scorecards, will result in greater trust, improved performance and cost savings for all parties.

Measure Carriers Based on Same Criteria

It is suggested that the performance of the customer's transportation carrier be measured in the same manner as the performance of the supplier's carrier. In other words, the customer's carrier should not be afforded any preferential accommodations.

Customer pick-up programs typically include the use of both the retailer's own equipment and for-hire carriers. The customer should not expect that his pick-up be loaded in any preferential order. However, if it has the flexibility to do so at no additional cost, the supplier is encouraged to load the customer's trailer expeditiously. This might be especially true if the supplier's own carrier is being loaded from a drop lot.

Likewise, suppliers are urged not to place any undue restrictions on the customer's carrier. While the use of high-cube trailers from the supplier's carrier may be a requirement, the supplier should take a flexible approach toward the customer's equipment. For example, delivery conditions at the customer's store may dictate the use of certain equipment types. Keep in mind that this flexibility may create additional costs which should be discussed between the customer and supplier during early team meetings and planning sessions. Using equipment that is consistent in type and size is the key to a win–win arrangement for the supplier and customer. Finally, customers should adhere to supplier/carrier requirements concerning safety and sanitation of the equipment.

Terms and Conditions Should be Established in the CPU/Backhaul agreement.
As with performance metrics, there are other cost drivers that need to be considered when establishing expectations for a strong CPU/Backhaul agreement. One of these cost drivers is the claims process for overages, shortages and damages. However, cost drivers could also include unauthorized deductions or charges related to service failures.

Each supplier and customer should outline and discuss the process that his or her respective company uses to resolve these issues, and then agree upon a specific solution up front. Given the many ways in which this activity can be tracked and measured, as well as the different approaches that suppliers and customers may take in seeking resolution, both parties must be flexible. Procedures regarding the handling of over, short and damage claims should be clear and easy to follow. Reasonable requirements for reporting of claims should be established.

Finally, it is also important that the terms and conditions clearly state the consequences for either party should it not fulfill the specific requirements agreed upon within the contract.

Customer Should Reflect Supply Chain Savings in Cost Calculations
Given that net-landed costs include inbound freight costs (as well as other handling costs), savings generated by backhaul programs should be reflected in such cost calculations.

Concluding Comments

(With a Reference to Information Technology Systems)

While much of the work undertaken by our committee was focused on tactical solutions to improve current backhaul programs, we are aware of the need for both suppliers and customers to develop long-range, strategic approaches to supply chain, transportation and distribution activities. While efforts to reduce transportation costs have an immediate and positive impact on profitability, strategic investment in processes and technology that provide greater collaboration, connectivity, speed and visibility are essential to attain marketplace leadership. It is through these processes and technologies that leaders will improve customer service.

In order to achieve the required level of customer service in the future, both suppliers and customers will need a supply chain that has reduced lead times and cycle times, is predictable in every step and provides real-time collaboration around exceptions and responses. This supply chain will be supported by a variety of systems, including next-generation Transportation Management Systems (TMS). While a review of possible scenarios and recommendations for implementation is clearly beyond the scope of this paper, both suppliers and customers are urged to develop processes and technologies that are collaborative and scalable. We do not recommend a single, best method for creating these processes and technologies, but suggest that we focus on creating adaptive supply chains, where collaborative environments are created within our organizations and with our trading partners to achieve the highest levels of customer satisfaction and value.

Appendix I

Collaborative Communication & Planning Model

	Annual Logistics Planning	Tactical Logistics Planning	Period Review & Measurement
Who: • Category Management • Sales Management • Supply Chain Management	**Who:** • Supply Chain Leaders Who Will Drive Process (Warehouse & Transportation)	**Who:** • Transportation Managers • Warehouse Managers (Executors)	**Who:** • Transportation Managers • Warehouse Managers • Champion from Each Partner
Objective: • Understand Category Plan to Develop Supply Plan	**Objective:** • Understand Partner Strategies • Understand Partner Priorities • Understand CPU Methodology • Identify Execution Risks to Category Management • Transportation Collaboration	**Objective:** • Define Delete/CPU Plan • Define Metrics Plan • Define Execution Action Plan • Metrics Execution	**Objective:** • Measure Performance • Adjust Actions • Resolve Issues • Identify & Document Success
Agenda Topics: • Annual Category Plan	**Agenda Topics:** • Strategies • Issues • CPU Formula/Rates/Metrics • Risks • Previous Performance Metrics	**Agenda Topics:** • CPU Execution • Delivery Execution • Category Support Plan	**Agenda Topics:** • Metrics Performance • Issues • Value Generation
Deliverables: • Topline Promotion Calendar • Understanding of Key Customer Strategies	**Deliverables:** • Mutual Agreement on Transportation Objectives • Execution Priorities • CPU Strategy • Execution Risk Feedback to Sales/Category Management	**Deliverables:** • CPU Tactics • Risk Action Plans • Metrics Plan	**Deliverables:** • Performance Evaluation
Frequency: • Annual	**Frequency:** • Annual	**Frequency:** • Annual	**Frequency:** • Review - Semi Annual • Metrics - Monthly

***SHOULD BE SCHEDULED CLOSE TOGETHER IF NOT ON SAME DAY!**

Appendix II

Manufacturer & Distributor CPU/Backhaul Agreement Template

This template includes suggested items that should be covered within supplier & customer CPU/Backhaul agreements:

1. Rates
- a) Customer pick-up allowance rates
- b) Pick-up allowance structure describing the components of the allowance (e.g. per CWT, per case, per pallet, fuel surcharge, unloading, etc.)

2. Warehouse operations
- a) Pick-up appointing process
- b) Shipping hours of operation
- c) Drop trailer procedures

3. Equipment specifications
- a) Trailer size
- b) Trailer cleanliness
- c) Trailer type (e.g. refrigerated, dry, insulated)
- d) Load temperature requirements

4. Driver requirements
- a) Counting
- b) Checking in
- c) Signing for load

5. Shipping platform information
- a) White wood
- b) 3rd Party Pallet Pool
- c) Slipsheets

6. Customer performance requirements
- a) On-time pick-up
- b) Regularity of program participation
- c) Order lead time
- d) Proper equipment

7. Overage, shortage and damage procedures
- a) Documentation requirements
- b) Communication process

8. Conflict resolution procedures

9. Performance management
- a) Periodic review of each party's performance to agreed-upon metrics

FOOD MARKETING INSTITUTE

655 15th Street, NW
Washington, DC 20005
(202) 452-8444
(202) 429-4529
www.fmi.org

GROCERY MANUFACTURERS OF AMERICA

2401 Pennsylvania Avenue, NW #200
Washington, DC 20037
(202) 337-9400
(202) 337-4508 fax
www.gmabrands.com