

## From Outsourcing to In-sourcing: Bringing Freight Management In House to Generate Sustainable Cost Savings at a Major Medical Products Company

The client is a U.S.-based \$200 million manufacturer of adult disposable medical products that sell through both wholesale and retail channels. The company was formerly part of a major consumer packaged goods corporation.

### The Business Challenge

As the Baby Boomer generation ages and shows signs of living longer than any previous generation, demand for a wide range of products for the elderly is increasing rapidly. Given the company's offerings and its sharp focus on elderly consumers, the company's prospects for growth were very bright. However, profitably capitalizing on those growth opportunities was becoming a challenge as the company experienced escalating costs to transport its products to the hospitals, long-term care facilities, medical supply companies and retailers it served.

The company had made some initial attempts to increase efficiencies and reduce freight costs, including outsourcing responsibility for outbound freight to a third-party logistics provider. However, although the 3PL did generate some savings over a two-year span, the company's annual freight costs still represented a significant 7.5 percent of sales, or \$15 million. The company's chief executive officer sensed more savings were possible. "We knew we had improved our performance on shipping," he noted, "but we wondered how much additional improvement we could make and how it could benefit us."

Unsure how to identify and implement those improvements, the CEO ultimately approached Supply Chain Edge for help.

### How Supply Chain Edge Helped

SCE has extensive experience helping a wide variety of companies improve their operations, and is especially adept at wringing excess costs from logistics.

SCE typically begins such a project by conducting an in-depth assessment—which, in this case, involved the company's shipping operations. The assessment encompassed not only the company's internal staffing and relationship with the 3PL, but also the company's customer locations, its annual inbound and outbound shipments and their costs, and the total weight and volume shipped by the company through each of its distribution channels. SCE also closely studied the company's costs for shipping a year's worth of product, which involved reviewing and analyzing more than 16,000 records.

SCE's analysis uncovered a number of shortcomings that were contributing to the company's high shipping costs. One shortcoming was that the company lacked sufficient data for reporting, measuring, and managing its freight processes (for instance, invoices from its freight vendors were often late or inaccurate, which negatively affected the company's financial processes). In addition, data provided by the 3PL was transactional in nature and focused on the carriage of goods; it did not enable the company to easily track shipments or manage the end-to-end freight process. Furthermore, the freight data the company did have came from multiple sources and resided in separate databases, making analysis and measurement more difficult.

The fact that no single executive within the company had direct accountability for freight further impaired the company's ability to effectively manage its freight-related data, or to benchmark and control its freight costs. For example, although freight was the company's second-largest spending area after materials, it

had no formalized plan in place to audit and optimize this spending because no one effectively was “in charge.”

SCE’s findings clearly revealed the company’s existing freight operations were not optimal and were a major contributor to the company’s high transportation costs. But they also raised an important issue: Perhaps the company was not benefitting from the outsourcing relationship with the 3PL and, in fact, could manage those operations more effectively and efficiently in house.

This may sound counter-intuitive, as outsourcing generally is viewed as being more cost effective and efficient than managing in house for certain types of functions and activities (freight management typically being one of them). And certainly, many companies have experienced significant cost savings by outsourcing freight management to a 3PL. However, as SCE evaluated the company, it became clear that the company had several key characteristics that made in-house management of freight the more appropriate (and profitable) option.

One characteristic was clout. In many cases, a driving factor to outsource is to take advantage of an outsource provider’s collective buying power. However, the company is a leader in its industry and, thus, has sufficient influence to negotiate favorable shipping rates from carriers on its own.

Another characteristic is the lack of supply chain complexity. While a complicated supply chain is strong justification for working with a 3PL, this company had a very simple supply chain, with a limited number of domestically sourced inputs and just two distribution centers.

The third characteristic is talent. Many companies that outsource functions or activities do so because they lack the appropriate skills in house to effectively manage them. Such was not the case with this company, which had had a talented supply chain staff already in place who could assume responsibility for freight management.

In the end, SCE determined that the company could, indeed, generate significant improvements by “in-sourcing” its freight operations—to the tune of between \$1.7 million and \$2.3 million annually, even after accounting for the costs associated with creating and launching a new in-house freight management function. Buoyed by

this strong business case, the company’s CEO expressed strong support for SCE’s recommendation and asked SCE to help make this new department a reality.

SCE managed the entire process, from scoping the role of the new function and determining what types of roles would be required, to creating job descriptions, recruiting new employees, choosing and implementing a new transportation management system (TMS) and,

ultimately, negotiating contracts with freight carriers. SCE also conducted an initial risk assessment of bringing freight management back in house to identify and minimize potential disruptions to the business.

One of the most important elements of the process was establishing the role of the freight management function within the larger company. It was critical to success that the function have clear accountability for the profitable management of the company’s freight and logistics and that it be free of the control and leadership problems that had plagued the company’s operations in the past.

Another critical aspect was staffing the new freight management department. Based on SCE’s previous experience and in-depth analysis of the company’s circumstances, SCE determined that two additional positions should be created, growing the total freight management function to four dedicated resources. The SCE team worked with the company to create detailed job descriptions, and then helped the company recruit candidates to fill those positions. One of the new roles ultimately would be filled by a person from outside the company. However, the other was filled by a current employee, who had previously managed the company’s relationship with the 3PL—which meant he already was intimately familiar with the company’s

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operations, required little training, and could quickly add value to the new function.

In addition to designing jobs and filling them with the right people, SCE played an instrumental role in acquiring the technology that would power the company's new freight management function. Given the challenges the company had encountered previously with data management, the new TMS had to be user-friendly and able to provide a wide range of useful insights from the company's freight management data, including a readily accessible view of the flow of products through the company's supply chain.

With these parameters in mind, the SCE team conducted an intensive due diligence process, evaluating a number of potential systems and ultimately choosing one that most closely met the company's cost and performance needs. After procuring and implementing the new TMS, SCE trained all of the company employees who would be using it.

The final issue the company had to address was building sustainable relationships with carriers. Because the company had limited experience negotiating with carriers, SCE led the request-for-proposal process, with a focus on establishing long-term, performance-based contracts. The SCE team helped the company ensure that the selected carriers' performance would be mea-

sured on an ongoing basis by meaningful, controllable metrics that directly related to the company's financial performance.

However, some of the factors that impact the cost of freight cannot be controlled—chiefly the price of fuel. To manage this important variable as much as possible, SCE helped the company develop a clear and logical fuel surcharge schedule to be adopted by each of its transportation vendors. This schedule, which was based on average levels of truck efficiency, provided financial incentives to transportation vendors that could achieve higher levels of efficiency. In other words, it reflected a chief tenet of sustainable cost management: The most effective measures have the potential to benefit all participants in a transaction.

Indeed, SCE has been instrumental to the client's pursuit of such long-term, sustainable savings. For instance, SCE's in-depth analysis of the company's freight data enabled the company to forecast future consumption of all its products by each of its customers. This, in turn, drove the development of several different scenarios for the company's distribution network, including both the elimination and the construction of distribution centers. Ultimately, SCE's analysis helped the company decide to consolidate its two existing distribution centers into one, substantially cutting the company's overhead costs

### Three Levels of Savings

Regardless of the state of the economy, companies always are on the lookout for ways to reduce costs to boost profitability. But costs—and cost-savings initiatives—are not created equal.

In our experience, cost-savings initiatives generally are carried out at three distinct levels. The first level, which is the easiest to pursue quickly, consists of *one-time transactional savings*, such as demanding that vendors charge less (which, in the case of this company, involved negotiating lower rates from carriers). However, such savings also can be difficult to repeat and sustain as market dynamics evolve. For instance, many motor carri-

ers gained increased leverage over their customers as a result of consolidation during the downturn, and as such were able to gain market strength and exact onerous fuel surcharges—compensating for any rate discounts they had granted in previous years.

The next level of savings emphasizes the *lowest possible total cost of ownership* as opposed to cost savings that benefit one area of the business more than another. For example, consider the sourcing of finished goods from China: While the reduced unit cost improves the perceived effectiveness of a company's procurement function, it can be offset by the negative companywide effects of in-

creased shipping costs, the potential for quality issues, and slower lead times.

In our experience, even larger and more *sustainable cost reductions* can be generated by what we call measured process improvement—the type of cost reduction pursued by the adult incontinence products manufacturer. At this level of cost savings, business processes and cultural norms are examined and re-engineered as necessary to drive corporate-level results. This approach can require major change—including personnel changes and capital investment. However, when done right, it can result in substantial cost savings and truly improve a company's performance for years to come.



without impacting customer service levels or hampering the company's growth.

Finally, SCE worked with the company to enhance its application of key principles of freight and logistics management to drive optimal performance for years to come. For instance, SCE helped the company develop supply chain disaster recovery plans, understand how reducing its pipeline inventory accelerates the cash-to-cash cycle, and adopt a more advanced understanding of variable cost drivers. Perhaps most importantly, SCE worked with the company to help it become a better, more proactive customer of transportation services, working collaboratively with vendors to drive down their costs, and hence, their pricing.

### Results and Benefits

SCE was confident that the company could reach or even exceed the cost savings estimates emerging from SCE's analysis. And exceed the company did: At the conclusion of the six-month project, the company's new freight management function was on track to achieve \$3.3 million of savings in the first year—nearly double SCE's estimate and a 10X return on the total investment in the project. Importantly, the vast majority of these savings are of the sustainable kind because they are the results of structural changes in process that permanently eliminate inefficiencies and redundancies (see the sidebar for more on the three types of cost savings companies can achieve).

However, sustainable cost savings aren't the only benefit. The company's new TMS enables every

employee to quickly access shipment history and real-time package tracking status and provide that information to customers. This has been especially beneficial to sales people, who previously had to spend considerable time and effort tracking down customer shipments. The new system further enables the company to automatically provide its customers with advanced shipment notifications, taking the guesswork out of deliveries while reducing administrative work.

Beyond achieving better customer service, the company has dramatically improved its freight payment processes. While the previous arrangement had been notable for the volume of paper it generated and for delays and problems with invoices, the current TMS-powered process is virtually paperless and error-free. As a result, the company now can execute routine financial processes more quickly, accurately, and efficiently.

Reflecting the success of the project are the comments from the company's CEO, who is understandably pleased with the return on his investment in SCE. "We always felt that we could do a better job managing transportation, but were never really sure where to begin," he said. "SCE was incredibly valuable, not only in pointing us in the right direction, but also in working hand-in-hand with us to make the transition from outsourcing to in-sourcing as smooth as possible. Their efforts have had a significant and measurable positive impact on our bottom line."

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## About Supply Chain Edge

Supply Chain Edge is a team of seasoned supply chain specialists who are highly skilled in identifying, quantifying, and capitalizing on opportunities that drive performance improvements in key areas such as business growth, earnings per share, return on capital, margins, cash-to-cash cycle times, and customer service.

Supply Chain Edge is unique in two important ways: Our extensive experience in numerous supply chain initiatives with dozens of companies enables us to bring best practices used by other enterprises to every project while working collaboratively with a client's existing internal talent. And, we don't simply advise clients what they should do, but instead, help them execute more effectively and efficiently to realize tangible, quantifiable financial gain.



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**Maximize Your Profits and Increase Your Competitive Edge.** Supply Chain Edge is a team of experienced supply chain advisors. SCE delivers improvements to key business metrics such as business growth, earnings per share, margins, return on capital, cash-to-cash cycle times, and expanded margins and profits to those clients we serve.