Managing Losses at Major Food Service Distributor –

- **Major and Minor Freight Loss and Damage Claims**

- **Unsaleables**

—*Solving a Multi-Million Dollar Problem*—

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1.0 Purpose

The intention of this paper is to provide a baseline idea of the hard- and soft-dollar costs Major Food Service Distributor (MFSD) will save or recoup by implementing a comprehensive freight loss and damage claims management system (myEZClaim.com). The intent of this system will be to enforce a uniform reporting and recovery process across MFSD's 80 mainline distribution centers (DCs).

This uniform process will:
- streamline and accelerate the filing of freight loss and damage claims, thus lowering soft-dollar back office costs for claim initiation, follow through, recovery, and accounting
- increase hard dollar recovery rates from MFSD's freight carriers
- provide comprehensive reporting for all classes of claims, thus helping MFSD (for example):
    o scorecard freight carriers
        ▪ identify best carriers
        ▪ identify problem carriers
        ▪ identify problem shipping lanes
    o identify problem SKUs
    o identify problem customers
    o identify problem suppliers
    o scorecard DCs
        ▪ identify best DCs
        ▪ identify problem DCs
    o identify problem packaging

2.0 Three Focus Areas

This discussion will examine three focus areas:

Minor Freight Claims – claims where the overhead of filing, tracking, settling, and accounting for a claim exceeds its recovery value. These claims, as defined by MFSD, have a recovery value under $100.

Major Freight Claims – claims where the recovery value of a claim exceeds its back office overhead. Specifically, these are claims with a recovery value exceeding $100.

Unsaleables – product that is returned to MFSD by its customers because it is unsaleable. Product could be returned for a number of reasons: beyond the 'use by' date, spoiled, cosmetically damaged (e.g. dented cans), packaging changes (e.g. new labeling obsoletes 'old' product), etc.

3.0 Data Sources

Because there is effectively no hard data available in the food service industry when it comes to freight loss and damage claims, and unsaleables, the conclusions drawn herein are based on <u>conservative</u> "best guess" information provided by MFSD; empirical data provided by companies spanning many industries.

4.0 The Problem

4.1 Reporting Claims – A Mixed Bag

Currently MFSD's DCs use a variety of ways to track 18,000 annual claims[1]. Some use a legacy computer tracking system. Some use Microsoft Excel spreadsheets to log and track their claims. Some record their claims using pencil and paper.

Obviously, with such disparate reporting methods it is difficult, if not impossible, for MFSD to aggregate this data into a central database for proactive analysis and action.

Also, because there is no established hierarchy for filing and tracking claims it may well be that claims are filed on a 'catch-as-catch-can' basis. It is hard to know—since very little *is* known. If this is the case, it means that many *major freight claims* probably go un-filed, and others that are filed receive no follow-up and expire as they exceed legal statutes of limitations set for freight loss and damage claims. This process inefficiency must leave a substantial amount of recoverable "money on the table" every year as well as necessitating additional sales "churn" to offset the unrecovered, and unknown loss (see section 4.5).

Added to this is the fact that, according to data provided by MFSD, <u>none</u> of its approximately 36,000[2] *minor freight claims* are logged and tracked.

4.2 No Leveraging Of Claim Data

Because there is not a loss and damage database filled with specific information about these 54,000 [conservatively estimated] claims (18,000 major + 36,000

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[1] The 18,000 claims a year number, spread across 80 DCs, is a cautious "best guess" supplied by MFSD.

[2] This estimate, like the one above, has been supplied with the qualifying statement that "this is a conservative estimate."

minor freight claims), MFSD does not have important data available to it that it can sift, categorize, analyze, leverage, and act upon.

For major and minor claims this means that a few savvy managers at individual DCs may understand their claims picture and be working to correct it, but this is claims mitigation on a micro level. Since MFSD's claims data is elusive, it will be impossible for MFSD to ever "see the big picture" and understand their freight loss and damage claims on a macro level. At the micro level a dose of medicine may be applied here, and another over there, but unless a holistic approach is taken the "macro patient" will never achieve optimum health. And as MFSD's business continues to grow, as it has in previous years, its claims problem will grow in lock-step proportion.

4.3 Lack Of Data Cripples Claim Management

When it comes to major and minor claims MFSD, except on a 'gut' level:
- will not know who its best and worst carriers are—and why
- will not know who its best and worst suppliers are—and why
- will not know which DCs have the highest and lowest claim volume—and why
- will not know which SKUs experience the greatest and least amount of damage—and why
- will not know whether it is filing more or less claims this year than last—and why

4.4 Lack Of Data Exacerbates Unsaleables Problem

As to unsaleables MFSD:
- will not know which suppliers account for a disproportionately larger amount of unsaleables
- will not know which type of unsaleable product is returned most often
- will not have the opportunity to work with its problem supplier(s) to correct troubles tied to the unsaleable nature of the product
- will not, in some cases, be able to prevent the defection of customers to other food service suppliers (e.g. Sysco) because of the loss of goodwill

4.5 The Claims-To-Sales Ratio—Putting The Cost Of Claims In Perspective

The food service industry, because of its commodity nature, runs on razor thin margins. True, there are higher margin specialty lines that turn in delicious profits, but most every broad based food service supplier must excel at cost containment. This is one reason why freight loss and damage claims, as well as

unsaleables, can be such an insidious, bottom line cancer. The table below shows how severe the problem can be.

IF YOU OPERATE AT NET PROFIT OF	A CLAIM FOR						
	$50	$100	$200	$300	$400	$500	$1,000
	EQUALS SALES OF[3]						
2%	$2,500	$5,000	$10,000	$15,000	$20,000	$25,000	$50,000
3%	1,667	3,333	6,667,	10,000	13,333	16,667	33,386
4%	1,250	2,500	5,000	7,500	10,000	12,500	25,000
5%	1,000	2,000	4,000	6,000	8,000	10,000	20,000
6%	833	1,667	3,333	5,000	6,667	8,333	16,667

4.5.1 Minor Freight Damage

It is understood that the average case price for product at MFSD is $30.[4] Figuring 36,000 claim possibilities at this cost yields an unaccounted for loss of $1,080,000 ($30 x 36,000). While $1,080,000 may seem like table crumbs for a multi-billion dollar food service company, the problem is much larger. Why? How? Well, if MFSD operates at a 5% profit margin, it will have to generate an additional $21,600,000 in sales to cover this "minor" loss!

But that's not all. The surface is just starting to get scratched.

4.5.2 Major Freight Damage

MFSD estimates it's major claim damage volume at 18,000 claims a year and postulates that the value of these claims is $150 to $200 each.[5] Using the bottom end of this dollar range (to keep estimates conservative) yields $2,700,000 in annual freight loss and damage claims ($150 x 18,000). Referencing the chart above, and supposing a 5% profit margin, means $54,000,000 in sales is needed to cover this loss. Or, looking at it another way, $54,000,000 in sales effort has been wasted.

4.5.3 More Than "Table Crumbs"

Since this mathematical exercise uses what are purported to be *conservative* numbers for major and minor freight loss and damage claims, it is easy to see

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[3] Source: Transportation Consumer Protection Council – www.transportlaw.com
[4] Dollar figure provided by MFSD.
[5] This dollar figure provided by MFSD was presented as being a conservative number.

how vital it is for a company with this type of claims-to-sales ratio to have a robust, comprehensive claims containment strategy. Without such an enterprise system providing "air cover" the sales burden necessary to cover the cost of claims, especially in a thin margin business, is oppressive to say the least.

Consider one other point. The dollar figures put forth for minor and major claims are conservative estimates of hard-dollar loss and damage costs and the offsetting sales effort necessary to balance the books. Remember though, claims losses have, until now, only been expressed as hard-dollar costs. It would not be a stretch to say that MFSD's soft-dollar costs linked directly to these claims could easily add 50% more to the cost. Some industry veterans argue, especially when considering the loss of customer goodwill and the long term value of a client, that the bump would be more along the lines of 100%.

Looking at the whole ball of wax, major and minor claims total to $3,780,000. Throw in half that again for soft-dollar costs and MFSD's claim exposure has ballooned to $5,670,000. The cost of sales needed to offset this loss at a 5% profit margin is a whopping $113,400,000.

Oh, and remember unsaleables? Their impact on the bottom line has not yet been discussed. One source at MFSD indicates that they could easily be two to three times the amount of the major and minor claims—$11,340,000 ($5,670,000 x 2). So to keep the math simple and conservative the total of claims ($5,670,000) and unsaleables ($11,340,000) will be added together ($17,010,000) and rounded down to an even $15,000,000. If one was to apply the 5% profit standard used above the amount of sales needed to be generated to cover this loss jumps to a staggering $300,000,000!

Is the math in this section off? Is it bloated? Then lower it by 25% and MFSD is looking at a $225,000,000 problem. Lower it 75% and MFSD is looking at a $75,000,000 problem. Cut that figure in half and MFSD is still looking at a $37,500,000 problem! These figures, whichever one chooses to settle on, are by no means table crumbs, even for a multi-billion dollar company.

5.0 The Opportunity

However MFSD chooses to calculate its un- and under-reported freight claims; its un- and under-reported unsaleables; the attendant soft dollar costs; the sales churn necessary to cover the claims; the ripple effect of loss and damage that touch other areas of its business; and more; there is opportunity for substantial gains to be realized in this area.

5.1 Leverage Business Intelligence

Just one gain, being able to use the business intelligence available by having all claims and unsaleable data captured in a single database, is enormous. The benefits of this business intelligence can be applied enterprise-wide: within MFSD as well as upstream to MFSD's supplier base, and downstream to MFSD's customer base.

5.2 Cost Avoidance

The cost avoidance benefits of less sales churn and the ability to limit and even prevent loss and damage claims and unsaleable situations will go straight to MFSD's bottom line. In a highly aggressive, narrow-margin business environment this alone can have a great impact on a businesses' competitiveness and even quarter-to-quarter stock price.

5.3 Near Zero Implementation Impact

Because MFSD already has people in place at its 80 DCs who handle claims it would not be difficult to implement an enterprise-wide process. And implementing a web-native solution for this from an application service provider would create no additional burden to MFSD's IT department (aside from ensuring Internet access for system users at each DC and MFSD headquarters).

6.0 The Solution – Process ESP: Efficiency, Savings, Power

Over and over companies that have implemented a comprehensive claims management solution—in this case TranSolutions' myEZClaim.com—have pointed to their root problem being the absence of a *process* to capture, report, follow-up, and resolve claims.

Read what three companies say about the value of putting the power of Process ESP to work in their enterprise.

6.1 System Users Speak:

One food product/food service company that has implemented myEZClaim.com relates that it had "too many claims" for the manual process and that it "was too hard to keep track of claims" once they were filed. Because of the roadblocks their lack of a systematic claims process presented, many claims went unreported, and at the very least were not methodically and thoroughly followed-up on.

This company, that experienced significant "people overhead" in filing claims manually, now finds that it "takes less than five minutes to input claims," and that the automation inherent in myEZClaim.com makes it much easier to keep track of, and follow-up on claims. And, since the system is web based IT overhead is nil "because all the myEZClaim.com software updates are done automatically. Our IT people never have to get involved."

Now this company's Transportation Supervisor says that his current situation "is not having to worry about doing claims manually and *letting the solution work for me instead of me working for the claims.*" It is not surprising that he adds, "I would highly recommend myEZClaim.com to anyone with a claims problem or any volume of claims."

A marquee food company that is home to some of America's most famous food brands uses this same claims management system. They were "experiencing a scheduling nightmare as we tried to manually follow-up dates and times for an effective mailing process [for our claims]. The task required a full time staff member to stay on top of our numerous claims each year."

With the implementation of myEZClaim.com this food manufacturing and distribution leader says "the software allowed our staff to stop trying to manually schedule and write the follow-up letters and provided an easy way to track our progress for auditing purposes. *We have reduced our staffing requirements to this task to approximately one hour a day.*"

In other words, considering a 48 week work year (deducting two weeks for vacations and two weeks for holidays), this company gets the use of this employee for other duties for 1,680 hours per year!

A large third-party distribution company with multiple warehouses, multiple customers, and multiple products leverages the ESP benefits of myEZClaim.com and says "we have transportation claims and warehouse claims. Our IT department created a database to help us track the claims we handled but the system was tedious to look-up claims and was not fool proof in preventing duplicate claims. We wanted a solution that would track our claims from start to denial or payment and enable us to prevent duplicates.

"The solution we chose was cost effective and easy to use. Our 'claim desk' used to be chaotic! Now the person that used to just do claims is handling other assignments. All the claim information is in the system and it prints out the letters we need to remind us of the follow-up required and tracks the claims all the way through to denial or payment. Our finance department likes the fact that we can include the payment information in the claim database. Finally, we're

able to eliminate duplicates by validating the order number we put in. We are very happy with the results."

7.0 Conclusions

7.1 There Is A Lack Of Process

MFSD has a significant amount of freight loss and damage claims as well as unsaleables that are not tracked to determine the root cause of these claims and unsaleables. There is no comprehensive, enterprise-wide system for reporting and resolving claims and analyzing claim data (including unsaleables data).

7.2 No Solid Cost Knowledge

MFSD, besides a general "gut feel", is unaware of the actual cost of its claims and their attendant soft-dollar costs.

7.3 The "People Infrastructure" Is There

Yet, at its 80 DCs MFSD has people who are familiar with claims and who, to varying degrees, file, track and resolve claims. Wouldn't it be wise to train and leverage the efforts of these people and apply their collective efforts to a single, comprehensive solution with all data collected in the same database?

7.4 Unsaleables Can Be Reduced

On the unsaleables side of MFSD's business, wouldn't it be wise to capture the pertinent data that created each individual unsaleable? There is little doubt that in many cases analysis of this data would reveal patterns that would lead MFSD back to its supplier or end user as the root cause of the unsaleable condition of the product. From there MFSD can negotiate better prices with its suppliers based on the hard data they now posses, or work with its suppliers and customers to mitigate many of their unsaleable problems.

7.5 No Wasted Effort Or Opportunities

Since many of MFSD's employees filing claims do not follow through on pursuing the claims to resolution the initial effort spent in filing a claim is basically wasted. Also, the opportunity to recover damages is lost and MFSD is denied proper remuneration.

7.6 Recommendation: Implement an enterprise-wide claims and unsaleables management system

Without being repetitive it becomes obvious that the implementation of a system to capture, manage, and resolve MFSD's currently un- and under-reported claims and unsaleables will produce positive results for MFSD in many ways.

The financial benefits pointed out in section four are forceful and may be eye-opening to those who have not thought deeply about this area of their business when considering *all* the costs of claims.

The ability to prevent and mitigate claims and unsaleables is compelling.

The dreaded impact of a company-wide software implementation on an always over burdened IT department is a non-issue with the hosted, web-native application myEZClaim.com.

Because training for myEZClaim.com can be delivered over the phone and over the web, training can take place without travel so the "usual" training expenses associated with new software are non-existent.

Since MFSD already has people in place at their 80 DCs who are claim savvy "uptake" will be much more immediate, and as has been demonstrated in section six, current users of this system indicate ease of use and tremendous time saving benefits. There is no doubt that MFSD would have similar results.

7.7 Cost

Just by recouping the wasted claims effort MFSD is now experiencing (due to lack of claim follow through) and realizing due compensation from claims that fall through the cracks and are not filed, MFSD will more pay for myEZClaim.com. Because the system can be paid for with "found money" its cost is effectively nil.

For "thumbnail numbers" though, the cost to implement, host, train, update, and maintain the system enterprise-wide on an annual basis would be less than 1% of the conservative "raw dollar" claim costs established in section 4.5.3 of $15,000,000. With further understanding of the scope of implementing and maintaining this system for MFSD (see attached "discovery" questionnaire) it would not be out of line to assume that the cost would be more towards 1/2% of the $15,000,000 baseline.

7.8 Timing

Because the myEZClaim.com system is web-native, implementation is painless as long as all of MFSD's users have Internet access, Microsoft Internet Explorer V. 5.0 or greater, and Adobe Acrobat Reader V. 5.0 or greater. Realistically 80 users could be online within 48-72 hours.

Training can be delivered individually or in groups. Again, all training is done over the phone and Internet. If done individually 10 to 15 people could be trained per week. To cover 80 people it would take six to eight weeks to implement and fully train all of MFSDs users.

7.9 Proof Of Concept

TranSolutions recommends that MFSD embark on a proof of concept (POC). This POC can be structured as MFSD thinks best, but it is recommended at least five DCs and corporate headquarters be tied together and trained. Then the POC can run for a reasonable amount of time, say 60 days, to establish the efficacy of the myEZClaim.com solution for MFSD.

7.10 TMS Ramp-Up Not A Barrier To myEZClaim.com POC

It is understood that MFSD is in the middle of installing an enterprise-wide TMS system and that this has the full attention of IT. Because of this, MFSD may be reticent to host a POC at this time but as a reminder, myEZClaim.com is web-native, requires no IT overhead, and all training is done without travel and can be scheduled to meet the needs of the individual user the implementation will not impact MFSD's TMS implementation.

TranSolutions feels that a concurrent implementation is best as it will facilitate early leveraging of MFSD's TMS system. When the myEZClaim.com POC concludes, MFSD will understand the power and flexibility of myEZClaim.com and might very well want to port data back and forth between myEZClaim and its TMS system. If the myEZClaim.com POC and (hopefully) subsequent implementation runs in parallel then that data mapping and sharing can take place at that time and not months in the future.

For all these reasons TranSolutions recommends that the suggested POC kick-off as soon as early January 2005. Because this is a POC there would be no cost to MFSD for use of myEZClaim.com or for training. If, at the end of the POC, MFSD decides not to fully implement myEZClaim.com all information stored in the system can be exported to Microsoft Excel so there will be no wasted effort and the data will be intact for MFSD's future use.

The one caveat to this is that MFSD and TranSolutions should enter into an "up front agreement" that if the POC is successful and that the goals are met, then MFSD will move ahead to full implementation at the price agreed upon prior to starting the POC.

8.0 Thank You

TranSolutions thanks MFSD for the opportunity to glimpse it business, and based on that glimpse build a business case for MFSD's use of myEZClaim.com as it's end-to-end claims and unsaleables management system. Be assured that all information that TranSolutions and its employees may have become privy to is confidential and will not be shared with any TranSolutions clients or prospective clients.

TranSolutions invites an open dialog to discuss any points of this value proposition paper and the business case developed herein. If MFSD would like to speak directly to the companies referenced in section 6.0, or any number of other companies who did not respond to our request for a written expression of their user experience before the deadline to do so arrived, TranSolutions will be more than happy to arrange such meetings.