

Welcome to:  
*The Top Five Categories to  
Source Now*

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# The Top Five Categories to Source Now

Patrick Furey  
*Senior Manager, Category Management*

Rachel Rutkoski  
*Category Manager, Transportation and  
Logistics*

Justin Falgione  
*Senior Category Manager, Services*



# Polling Question

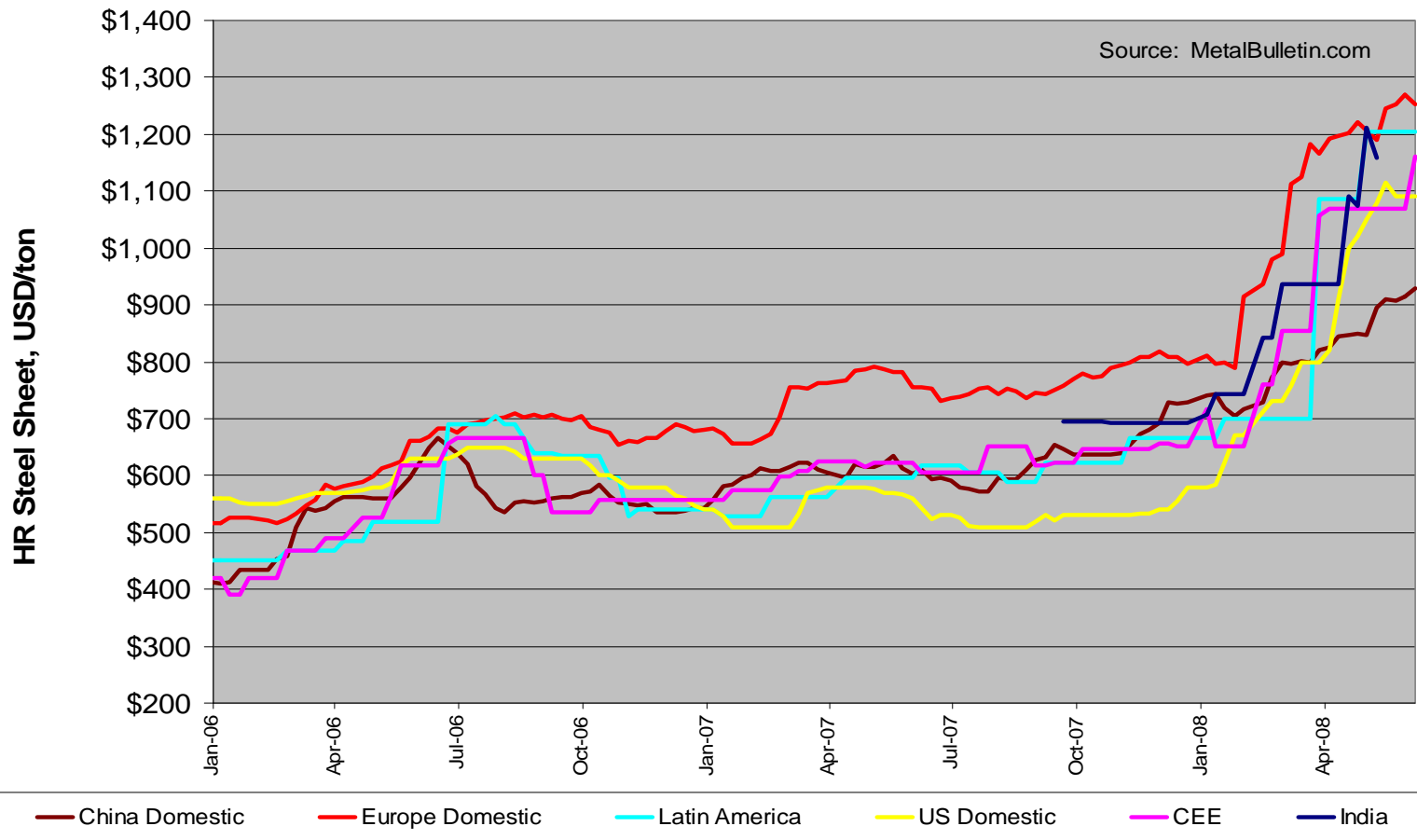
- ▶ Given current market conditions, in which of these categories/areas are you planning sourcing activity in the next 3-6 months?
  - ▶ A. Direct Materials (Metals, Plastics, Electronics)
  - ▶ B. Contingent / Temporary Labor
  - ▶ C. Travel Management Services
  - ▶ D. PCs / Workstations / Servers
  - ▶ E. Transportation (Truckload, Ocean, Air)

# ***#1 - Direct Materials***

# Recent Headlines from the *Wall Street Journal* Point to Inflationary Pressure in Direct Materials Markets

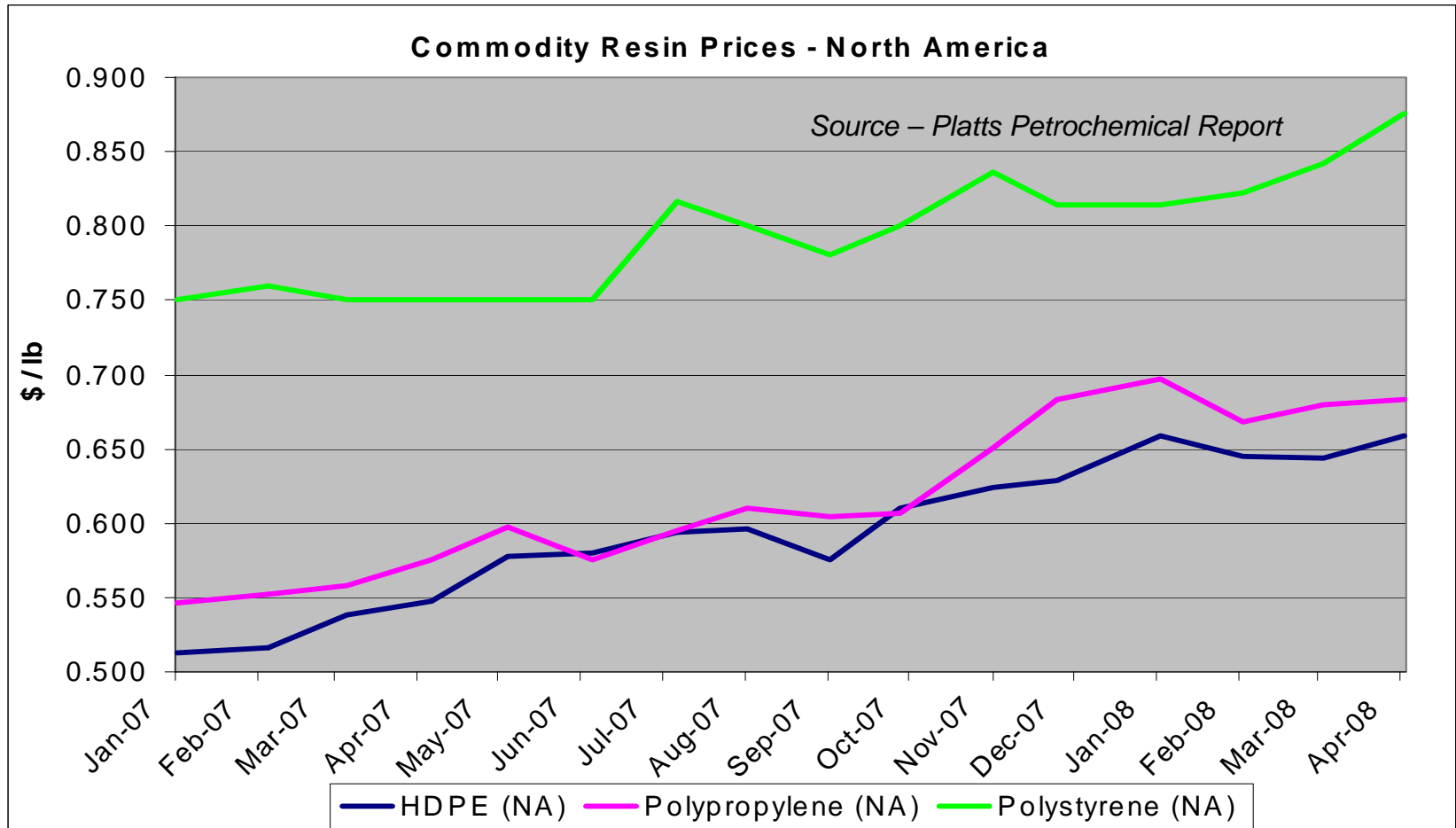
- *Copper Futures Stage Rally – June 19<sup>th</sup>*
- *Blue-chip stocks decline as oil prices rise sharply – June 17<sup>th</sup>*
- *Dollar declines against the euro amid mixed data – June 18<sup>th</sup>*
- *Dow Chemical to raise product prices by 20% - May 28<sup>th</sup>*
- *Inflation Now Enemy No. 1 for Fed - June 19<sup>th</sup>*

# Metals: Global Hot-Rolled Steel Pricing 2006 to Present



- ▶ Not only have the base metal prices behaved erratically, but metal buyers must also be cognizant of regional sensitivities to prices.
- ▶ Global shifts in prices for raw metals has a significant impact on suppliers' overall competitiveness from a total cost perspective.

# North American Commodity Plastics Resins Pricing, Jan. 2007 to Present



- ▶ Prices have spiked along with oil prices, although increases since January of 2007 have been less than 30 percent on average.
- ▶ Engineering grade materials have increased as well, but generally less than 20 percent.

# Polling Question

- ▶ How would you describe the impact of rising raw materials prices on your procurement organization?
  - ▶ A. Very High – Directly Impacting My Companies Bottom Line, Getting C-Level Attention
  - ▶ B. High – Facing Price Increases and Surcharges
  - ▶ C. Moderate – Suppliers are Grumbling, but Impact is Manageable
  - ▶ D. Low – No Impact

# Strategies in Direct Materials in Response to Current Market Conditions

- Look for labor-intensive processes and components with high value-add content – Assemblies, Machining, Stamping, Injection Molding, PCBAs
- **Insist on detailed cost breakdowns with all quotation packages to document raw material contribution**
- **Use price adjustment clauses in RFX and Contract language to reduce buyer / supplier risk**
- **Resist surcharges and increases without an “open book” policy**
- Source in region of usage
- One more strategy discussed on later slide

# Affect of Rising Prices on Processors

## Scenario 1: Material Greater than 70% of Cost

Part #	Mat. (\$/lb)	Part Wt (g)	Matl Cost	L&OH Cost	Total Cost/M	Price	Profit/Loss	Margin
XXXXX	\$1.00	100.00	\$226.60	\$81.02	\$307.62	\$353.76	\$46.14	15%
XXXXX	\$1.25	100.00	\$283.25	\$81.02	\$364.27	\$353.76	-\$10.51	-3%

25% Increase in Material Price Causes Supplier to Operate at a Loss

## Scenario 2: Material Less than 30% of Cost

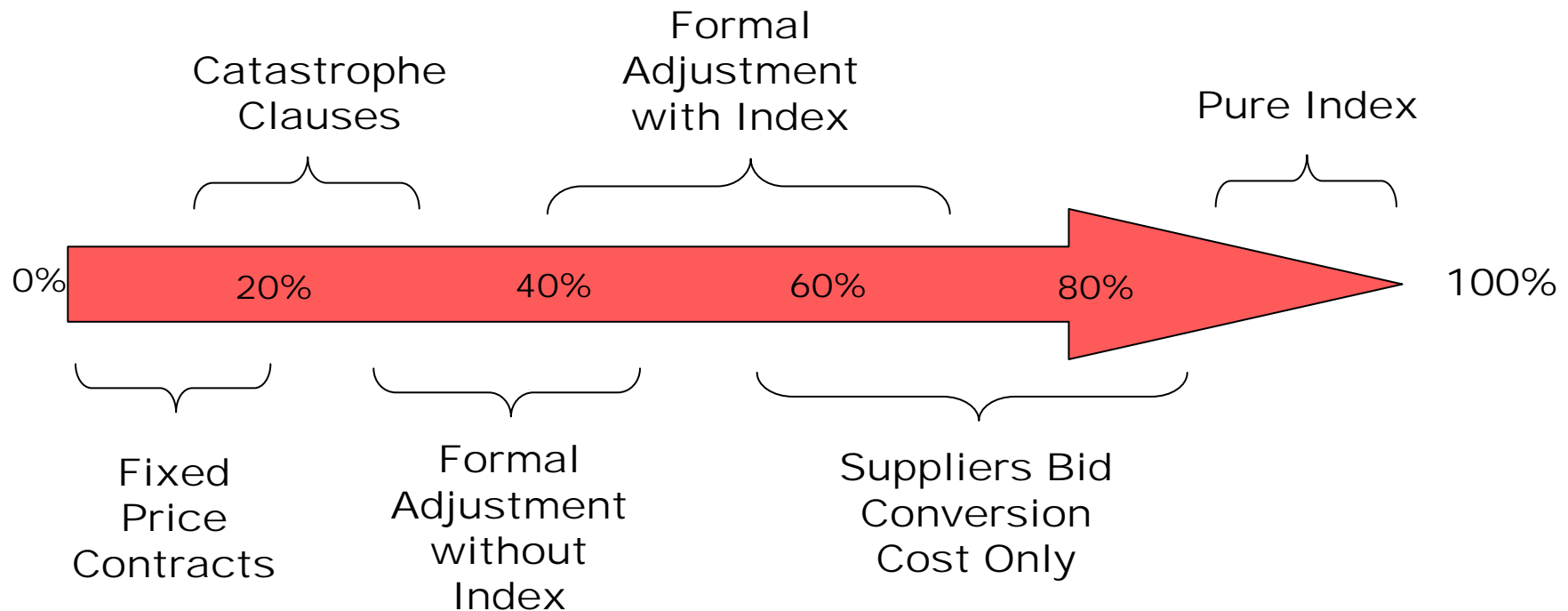
Part #	Mat. (\$/lb)	Part Wt (g)	Matl Cost	L&OH Cost	Total Cost/M	Price	Profit/Loss	Margin
YYYY	\$1.00	10.00	\$22.66	\$81.02	\$103.68	\$119.23	\$15.55	15%
YYYY	\$1.25	10.00	\$28.33	\$81.02	\$109.34	\$119.23	\$9.89	9%

25% Increase in Material Price and Supplier Remains Profitable

**Two Key Points – Price increases should not apply to every part, and price adjustments only apply to the raw material portion of cost**

# Impact of Raw Material Cost Component on Type of Price Adjustment Mechanism Used

## Raw Material Cost as Percentage of Total Product Cost



# Adjustment Mechanisms: Catastrophe Clause

- ▶ Only triggered in cases of severe market shifts
- ▶ Raw material minimum change threshold typically set at 20-30% change
- ▶ Proof of raw material change is typically letter or formal documentation from supplier
- ▶ Reaching change threshold triggers renegotiation on raw material cost component (often informal)

# Adjustment Mechanisms: Formal Clause

- ▶ Adjustments based on change in previous period's average raw material pricing (index or supplier cost)
- ▶ Formally document breakdown of suppliers costs and only allow raw material costs to fluctuate
- ▶ Limits for maximum increases/decreases are sometimes established and may be slanted to buyer
- ▶ Minimum change threshold typically set at 5% to 10%
- ▶ Buyers can apply their own raw material price if one is negotiated



# Adjustment Mechanisms: Conversion Only

- ▶ Buyer either pegs raw material cost directly to index or provides a material price to use
- ▶ Suppliers bid on all non-material related costs (processing, labor, freight, margin, etc.)
- ▶ Removing supplier's fears of raw material volatility often results in more aggressive overall pricing

# Adjustment Mechanisms: Pure Index

- ▶ Typically used for raw metal (Copper, Aluminum) or commodity thermoplastic resin (HDPE, PET, PP) purchases
- ▶ Suppliers bid a percentage or fixed dollar amount above or below a published index
- ▶ Selection of index must be done carefully, with consideration given to regional indexes for suppliers

# Strategies in Direct Materials in Response to Current Market Conditions (cont.)

- Look for opportunities in Indirect / Services categories

# ***#2 - Transportation***

**Air Freight / Courier Services**

**Ocean Freight**

**Truckload / Less Than Truckload**

# Polling Question

- ▶ What mode of transportation comprises a majority of your transportation spend?
  - ▶ A. Air Freight
  - ▶ B. Ocean Freight
  - ▶ C. Truckload
  - ▶ D. Less-than-Truckload
  - ▶ E. Courier Services

**A difficult economy is precisely the time to focus resources on cost control and increasing efficiency from operations.**

**The New York Times**  
ON THE WEB

*“Surging Oil and Food Prices Threaten the World Economy”*

*- New York Times, June 15, 2008*

**multichannel**  
INTEGRATE • SELL • DELIVER  
**merchant**

*“Rising Transportation Costs –and What To Do About Them .”*

*-Multichannel Merchant, November 13, 2007*

**Purchasing**  
**.com**  
Reed Business Information.

*“Trucking earnings hit by weak demand”*

*- Purchasing.com, April 23, 2008*



*“The volume decrease...and increased fuel costs during the quarter contributed to the declines in operating profit and margin.”*

*-UPS Annual Report, April 23, 2008*

**Today’s transportation market conditions are allowing companies to take advantage of softened markets and increased levels of competition**

# Air Freight: Current Market Conditions and Trends

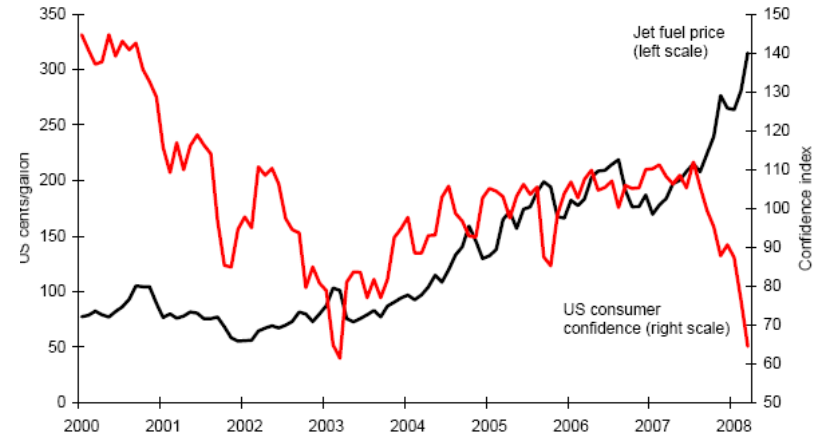
## ***Slowing Growth – Heavy Air***

- ▶ Air freight is continuing to lose market share as world trade is expected to grow by 7.5% by end of 2008 yet air freight is only expected to grow 4%
- ▶ Air freight force to become extremely aggressive with pricing in an attempt to improve low load factors that are averaging less than 75%

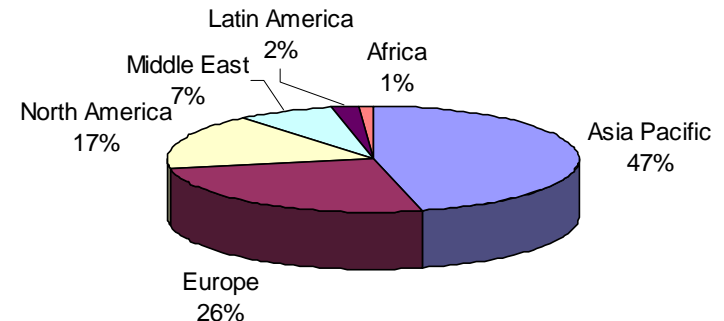
## ***Increased technology and competition***

- ▶ Competition between UPS and FedEx is as at all time high especially with DHL's reorganization

Consumer demand and fuel costs diverge abruptly breaking 5-year trend



Global Air Freight Market Share



Source: IATA Economics

# Ocean Freight: Current Market Conditions and Trends

## ***Capacity growth***

- ▶ Capacity is expected to grow 8-10% by end of 2008 as ship orders are finally completed
- ▶ Capacity for ocean freight is specific to a trade lane. There is more available capacity on Asia – North American lanes versus North American to Asia or between Asia and Europe
- ▶ Port congestion is at an all time low on both the West and East coast due to available truck and rail capacity to move freight inland.

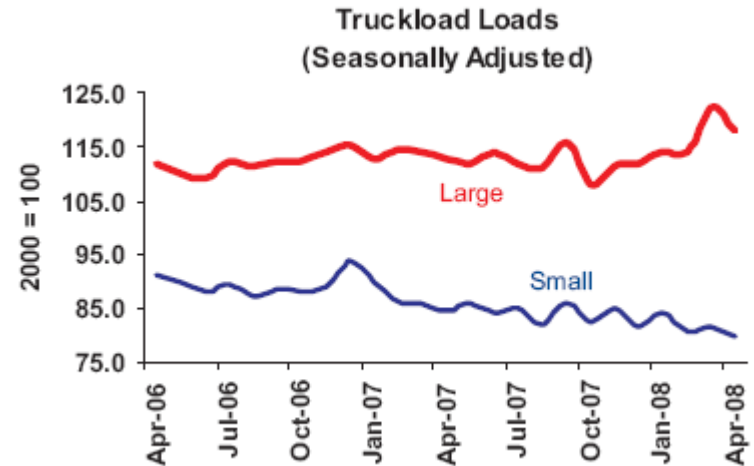
## ***Better efficiency***

- ▶ Ocean freight is becoming a direct competitor for air freight with faster transit times and more frequent sailing times

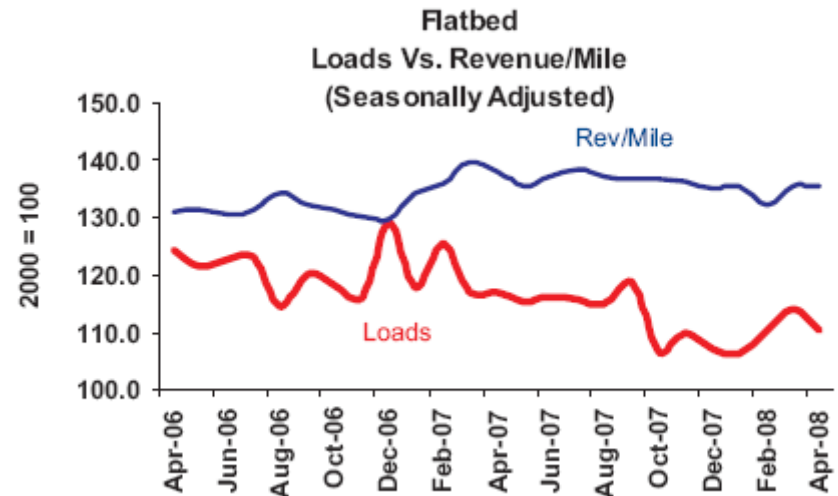
# Truckload / Less than Truckload Freight: Current Market Conditions and Trends

## **Excess capacity**

- ▶ Shift over the last 18 months
- ▶ Market is predicted to remain soft until economy improves
- ▶ Surging fuel prices are indirectly impacting freight volumes as consumers pay more for gasoline and have less money to spend on truck-transported goods.
- ▶ Refrigerated freight only truckload category that is showing improvements
- ▶ Flatbed hit the hardest due downturn in housing and construction market



Source: ATA Trucking Activity Report



Source: ATA Trucking Activity Report

# You need to understand the transportation cost structure to understand the impact you can have.

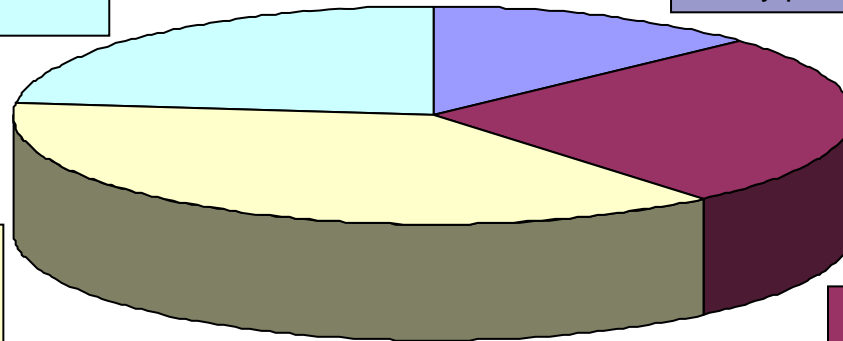
## Equipment

- 2007 Environmental regulations concerning engine emissions drove advance purchase of class 8 trucks
- As a leading industry contributing to environmental issues, carriers are being encourage to examine their own carbon footprint

## Accessorials

- Accessorials increasing as a percentage of overall transportations costs as carriers try to recover costs through these fees
- In the last ten years, accessorial charges for small parcel have increase from less than a dozen to over ninety possible charges

## Total Freight Costs



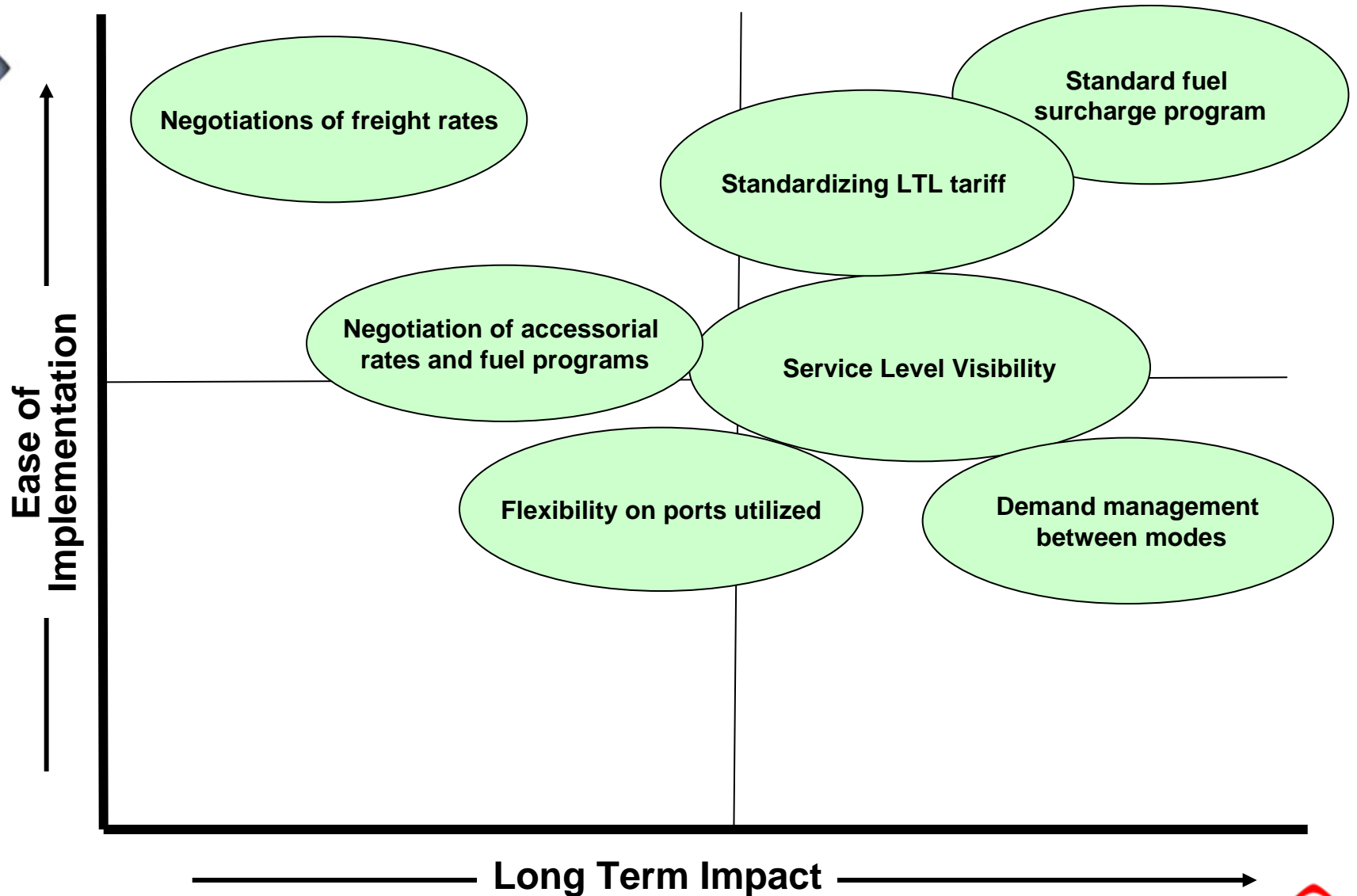
## Labor

- Driver shortages for Truckload ended at 113% in 2007 indicating it is still a major factor within the trucking industry
- Companies are having to pay higher labor rates to retain employees and ensure service levels remain consistent to customers

## Fuel

- Fuel at all-time high of \$130+ per barrel
- Geo-political instability and weakened USD will likely support high oil prices in the near future

Once you understand the cost structure, you can determine what levers you can pull to impact.

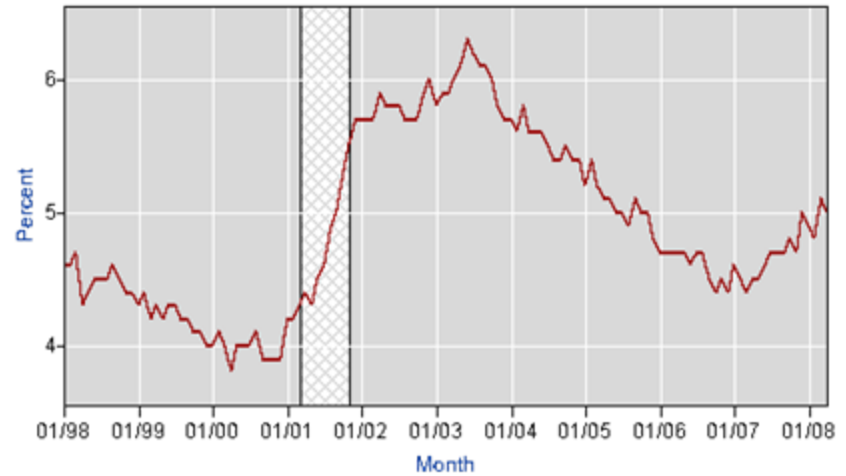


# ***#3 - Contingent / Temporary Labor***

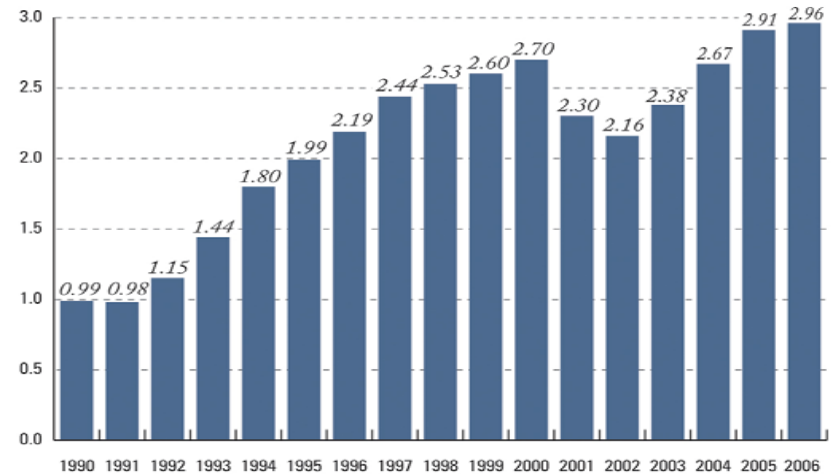
# Current Market Conditions and Trends

- ▶ Moderate demand resulting in some supply/demand imbalances in metropolitan areas across multiple categories (especially prevalent in IT)
- ▶ Slight increases in the unemployment rate in the US (after over 24 months at or below 5%)
- ▶ Minimum wage legislation that will impact many service providers indirectly
- ▶ The weakness of the US dollar and wage inflation in some offshore locations is driving some “back office” functions onshore

## US Unemployment Rate



## Temporary Staffing Average Daily Employment (Millions)



Source: American Staffing Association, Employment and Sales Survey

# What it Means for Contingent Labor Buyers

- ▶ ***Ensure contracts enable transparency to all mark-up components to:***
  - ▶ ***provide a fair profit, but manage overhead or other allocations;***
  - ▶ ***quantify mark-up associated with recruiting workers***
  - ▶ ***provide visibility into the SUTA, FUTA and Workers Comp components***
  
- ▶ ***Evaluate the current model utilized to procure/ manage contingent labor***
  - ▶ ***Consider the use of a labor management service provider***
  - ▶ ***If utilizing a labor management service provider, determine if the current model provides***
    - ***Robust # of qualified candidates for each position***
    - ***Candidates at “market rates”***
  - ▶ ***Consider all potential models (MSP, Vendor Neutral, Hybrid)***

# What it Means for Contingent Labor Buyers (cont.)

- ▶ ***Potential benefit from the deployment of a Contingent Workforce Management System (CWMS):***
  - ▶ ***systems streamline procurement and timekeeping***
  - ▶ ***provide both preventive and detective controls to facilitate demand management***
  - ▶ ***evaluate the Pros & Cons of independent system vs. provided by service provider***
  
- ▶ ***Evaluate the potential for use of offshore/nearshore labor for IT and other professional positions***
  - ▶ ***Leading providers are deploying a Global Delivery Model (GDM) that facilitates seamless delivery. Disciplined due diligence is required due to:***
    - ***Recent significant revenue growth (double-digit) of firms***
    - ***Varying levels of deployment of a GDM***
  - ▶ ***Organizational culture and requirements must be incorporated into the process***

# Polling Question

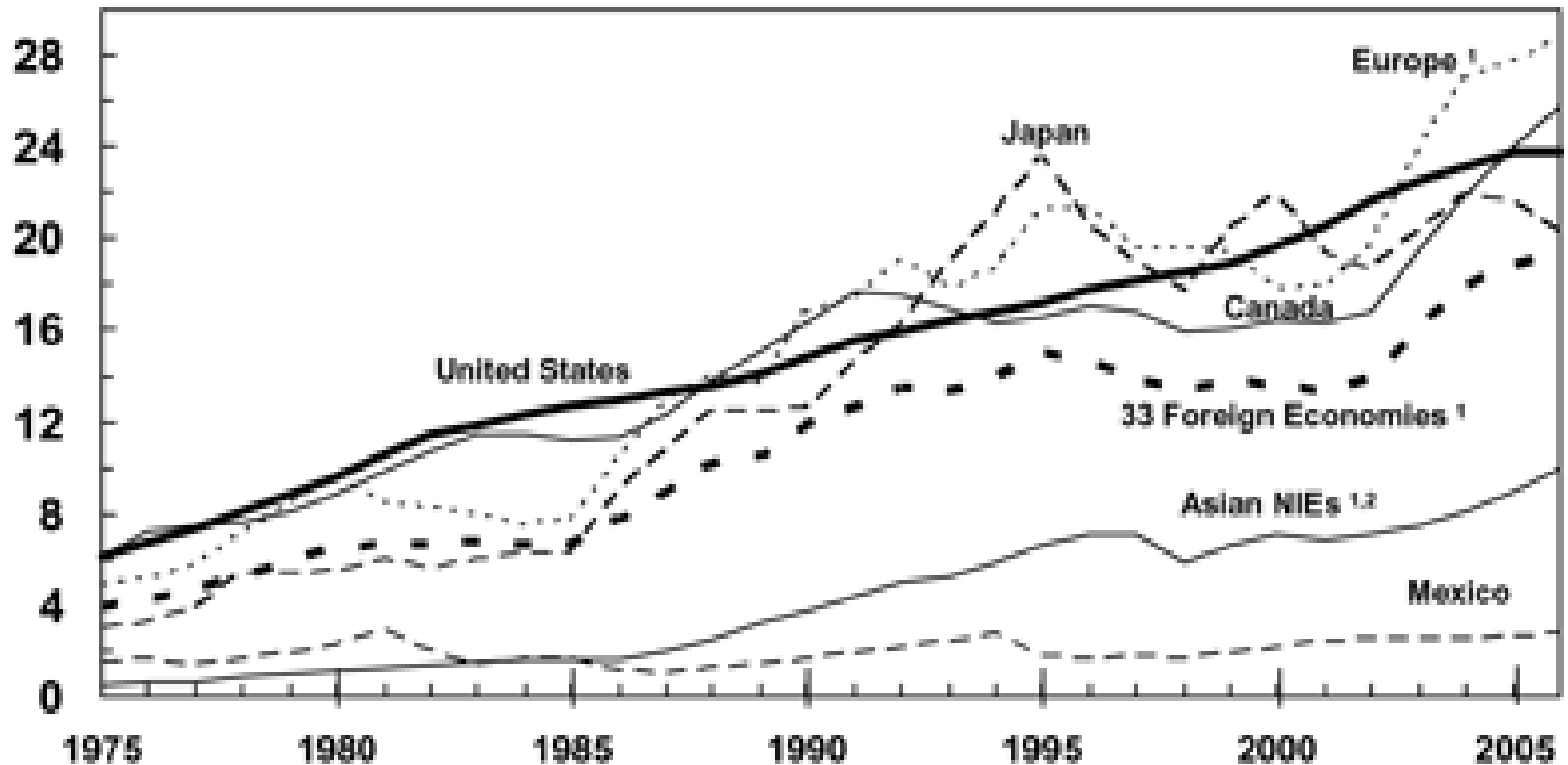
- ▶ What percentage of your contingent labor spend is currently under that management of a Managed Staffing Provider - either Vendor Neutral or Primary Vendor program?
  - ▶ A. >75%
  - ▶ B. >50% to 75%
  - ▶ C. >25% to 50%
  - ▶ D. 25% or less

# Increased Interest in Managed Staffing Programs Due to the Following Benefits

- ▶ Provision of market-specific knowledge regarding contingent labor processes, wage rates, and cost management techniques
- ▶ In many cases the vendor provides a contingent workforce management system and is well-versed in leveraging that system to manage cost and risk
- ▶ Reduction in the administrative time spent by internal personnel on processing requisitions, managing resume and interview flows, etc.
- ▶ Provision of metrics and reporting to facilitate active management of the cost and effectiveness of the contingent labor program
- ▶ Managed staffing programs provide scalability, allowing customers to staff up quickly with qualified personnel for specific projects or volume spikes
- ▶ Ability to provide rate and process benchmarking information based on exposure to multiple positions in multiple labor markets
- ▶ Assistance in managing regulatory risk (co-employment and 1099 reclassification) through their processes, as well as the management (hiring, discipline, etc.) of the contingent workforce
- ▶ Management of subcontractors to ensure an adequate base to satisfy requirements, as well as quality management of that subcontractor base

# Global Wage Costs Continue to Fluctuate Based on Wage Inflation and Currency Fluctuations

Hourly costs (\$)

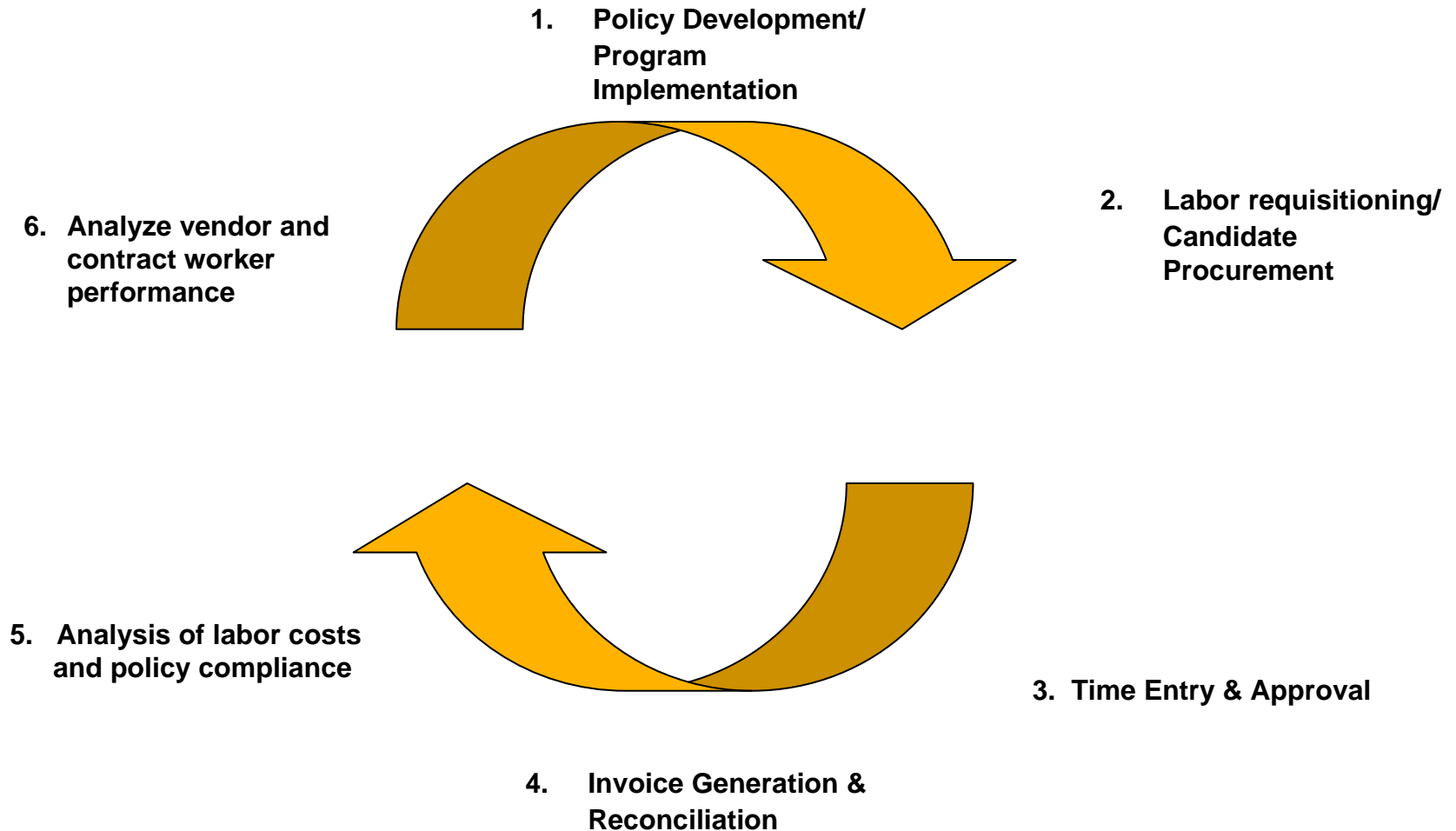


<sup>1</sup> Trade-weighted average

<sup>2</sup> The Asian NIEs are Hong Kong SAR, Republic of Korea, Singapore and Taiwan

**Source: US Dept of Labor; VentureOutsource.com February 2008**

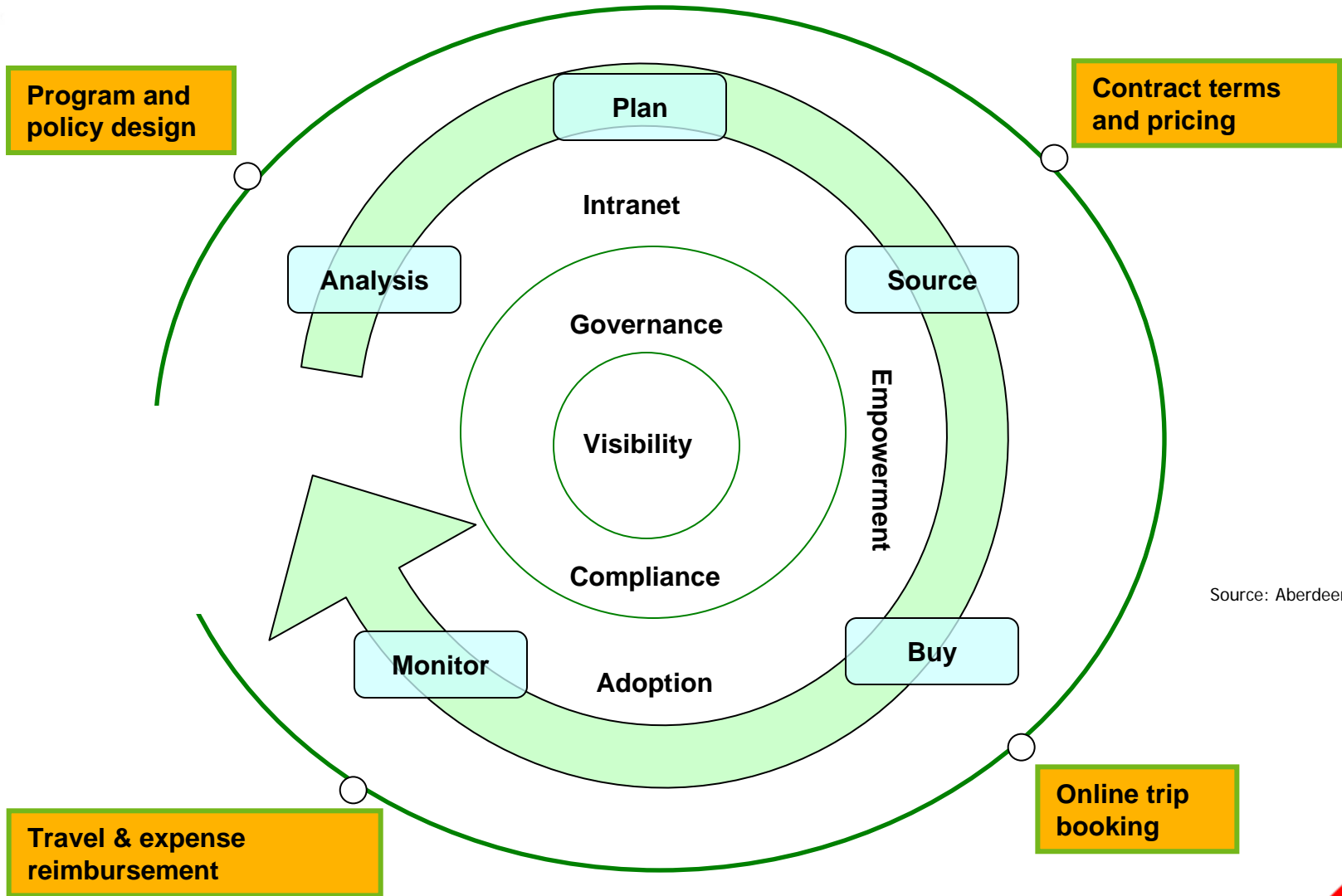
# Contract Labor Management Life Cycle



*It is imperative to address all aspects of the lifecycle to adequately manage cost*

# ***#4 - Travel Management Services***

# Companies will Evolve to Much More Holistic Travel Strategies



Source: Aberdeen Group

# Travel Cost Management Focus

- ▶ **Renewed interest in policy review/benchmarking**
  - ▶ Implementation of Stricter pre-approval processes
  - ▶ Approval levels and guidelines regarding connecting flights
  - ▶ Use of Self-Booking Tool compliance parameters (beyond “visual guilt”)
  - ▶ Strength of policy impacts all travel provider negotiations
- ▶ **Gaining a better understanding of the airline carrier profitability on your business (to increase negotiating leverage)**
  - ▶ Presence of low-cost carriers in your markets
  - ▶ Business or economy on international flights
  - ▶ High or low usage of advance purchase tickets
- ▶ **Focus on Compliance & TCO factors (high-speed internet, breakfast, parking, hotel/airport shuttles) as it relates to Hotel cost**
- ▶ **Concern with maintaining existing Rental Car pricing as long as possible, while strategically negotiating city daily surcharges**

# Sourcing of Travel Agency Services

**Ariba is noting increased activity in the strategic sourcing of travel agency services, although reduction in fees is often not the primary impetus (Agency Fees typically account for between 2 and 5 percent of total travel spend).**

The most prevalent reasons noted for the re-sourcing of travel agency services include:

- Access to enhanced booking and reporting technology that can drive policy compliance and appropriate traveler behavior (reporting by department regarding use of lowest logical airfare, compliance with the hotel program, etc.)
- Incumbent supplier account management team lacks the focus or capability to provide consultative programs to drive cost management and traveler satisfaction (incumbent complacency)
- Enhanced assistance in negotiating and managing airline, hotel and rental car programs (access to agency negotiated agreements/pricing, RFP process, etc.)
- Access to industry best practices as it relates to driving compliance with the overall travel program (use of agency and policy compliance) as well as increased utilization of self-booking technology
- Enhanced international capabilities as the travel programs of many organizations become increasingly global, and global cost per trip is materially higher than domestic travel
- Additional data and analysis tools to quantify cost management opportunities and to provide leverage in carrier and hotel property negotiations

# Travel Sourcing – Critical Success Factors

- Strong Policy which permits the direction / channeling of volume
- Compliance and Demand Management integrated into the corporate culture
- Solid usage data to permit effective negotiation (also, understanding the “value” of your spend)
- Sound relationships with major suppliers

## Analysis of the following key issues is also important:

- Contracts - how good are my discounts, are they structured appropriately?
- Sourcing – is it the appropriate time the “shake up” my preferred base? What is the value of corporate discounts vs. lowest logical fare?
- Value – is the travel program adding value to the organization?
- Policy – is our travel policy still consistent with the demographics and needs of the organization; can aspects be adjusted to reduce costs without materially impacting traveler satisfaction?

# ***#5 - PCs / Workstations / Servers***

# Current Market Conditions and Trends

- ▶ Worldwide mobile PC (laptop) growth is expected to remain strong this year, although growth in the US and Japan (more mature markets) will be modest
  - ▶ The four market share leaders continue to be (in order): HP, Dell, (HP recently replaced Dell as the leader) Acer, and Lenovo
- ▶ It is estimated that by 2010, Mobile PC units will approach parity and outsell desktops in mature markets and will approach a third of devices sold for emerging markets driving innovation in the mobile computing sector
- ▶ Interest in the Microsoft Vista operating system has been strong and continues to drive PC sales, with Microsoft announcing sales of 140 million copies through April 2008 despite some corporate hesitation to switch from Windows XP to Vista
- ▶ The next refresh cycle is expected to occur in the late 2008 to early 2010 timeframe which will drive pricing pressure as the OEMs compete for market share

# Key Factors Contributing to Competition within the Industry

## ▶ OEM Competition

- ▶ OEMs are looking to sell not just through the internet but are keen on developing more channel partners
- ▶ HP has taken the lead on market share in the overall PC segment from Dell
- ▶ HP and Dell have the leading industry positions in large and midsize accounts
- ▶ Vendors may have to invest more at a country level in order to appease to local demands. Smaller vendors may have an advantage here, as they do not need significant economies of scale to do compete in this strategy

## ▶ Services

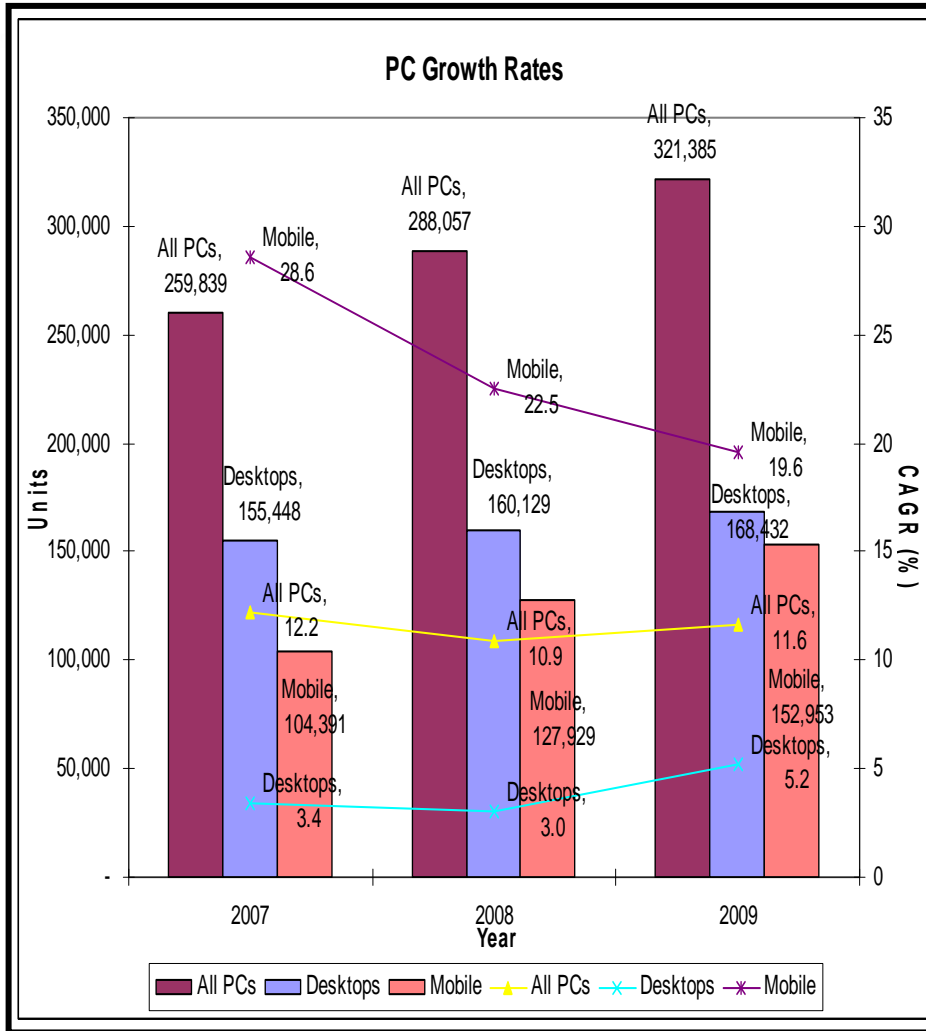
- ▶ Increasingly important for Lenovo, Fujitsu Siemens and Toshiba is to differentiate amongst life cycles, warranties, ease of procurement and configurations, disposal requirements and green issues
- ▶ Suppliers trend towards services increase competition to win hardware deals and then up-sell services and other post-sale revenue streams

## ▶ Pricing

- ▶ Continuous supply chain and operation improvements have assisted in price declines

Despite the current economic uncertainty, the PC market's overall projected growth rate for 2008 - 2009 is 12%.

### PC Growth Rates in Units and Percent



### Key Points

#### Growth Trends and Factors

- ▶ More than 300 MM units by 2009 and 1 Billion PCs in worldwide use by 2015
- ▶ Growth rate for the industry is fueled by small business and consumer sectors
- ▶ Weak replacement activity is negatively impacting growth in mature markets
- ▶ New technologies from AMD and Intel are not expected to drive market growth in the near term

#### Emerging Markets

- ▶ In emerging markets, 56% of shipments are new PC placements vs 23% in mature markets
- ▶ Emerging markets will contribute approximately 214 MM new placements to unit growth from 2007 through 2009
- ▶ China's demand is four times that of the US.
- ▶ China and Latin America still seem to be enjoying unprecedented GDP growth, further fueling the demand for PCs in these regions of the world

#### Pricing

- ▶ Average Selling Price (ASP) is expected to decline further through 2008 due to increased price cuts for processors and competitive pressures on suppliers

Source: Gartner

Note (1): The term *emerging markets* is commonly used to describe business and market activity in industrializing or emerging regions of the world. Examples of emerging markets include China, India, Mexico, Brazil, Chile much of Southeast Asia, countries in Eastern Europe, the Middle East, parts of Africa and Latin America

# Questions?

Contact us:

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